



ABSORPTION FOR EU PRE-ACCESSION FUNDS: CONCEPT AND IMPLICATIONS FOR KOSOVO

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List of Abbreviations

AA	Audit Authority
AEI	Agency for European Integration
CAO	Competent Accrediting Officer
CARDS	Community Assistance for Reconstruction, Development and Stabilisation ,
CBC	Cross Border Cooperation
CCs	Candidate Countries
CEB	Central European Bank
CFCF	Central Financing and Contracting Department
DIS	Desterilized Implementation System
DG	Directorate General
EAGGF	European Agricultural Guidance and Guarantee Fund
EBRD	European Bank for Reconstruction and Development
EC	European Communities
ECO	European Commission Office
EDIS	Extended Decentralized Implementation System
EIB	European Investment Bank
EPAP	European Partnership Action Plan
ERDF	European Fund for Regional Development
ESF	European Social Fund
EU	European Union
FA	Framework Agreement; Financial Agreement
FPs	Financing Proposals
FIFG	Financial Instrument for Fisheries Guidance
FPs	Financing Proposals
GDP	Gross Domestic Product
GNI	Gross National Income
GNP	Gross National Product
HRD	Human Resource Development
IB	Institutional Building
ICTY	International Criminal Tribunal for the Former Yugoslavia
IFIs	International Financial Institutions
IPA	Instrument for Pre-accession Assistance
ISPA	Instrument for Structural Policies for pre-Accession
IT	Information Technology
JMC	Joint Monitoring Committee
KDSP	Kosovo Development Strategy and Plan
MA	management authority
MC	Monitoring Committee
MIFF	Multi –annual Indicative Financial Framework
MIPD	Multi-annual Planning Document
MoF	Ministry of Finance
MTEF	Medium- Term Expenditure Framework
NAO	National Authorizing Officer
NF	National Fund
NGOs	Non Governmental Organizations
NIPAC	National IPA Coordinator
NPAA	National Programme for Adoption of the <i>Acquis</i>
NUTS	Nomenclature of Territorial Units for Statistics

OP	Operational Program
PA	Paying Authority
PCCs	Potential Candidate Countries
PHARE	Poland and Hungary Action for Restructuring of the Economy
PIFC	Public Internal Financial Control
PISG	Provisional Institutions of Self Government
PPP	Purchasing Power Parity
RD	Regional Development
SAA	Stabilization and Association Agreement
SAPARD	Special Accession Program for Agriculture and Rural Development
SCO	Sectoral Coordinator
SIGMA	Support for improvement in governance and management
SMC	Sectoral Monitoring Committee
SMEs	Small and Medium Enterprises
SPD	Single Programming Document
SPOs	Senior Program Officers
TA	Technical Assistance
TAIEX	Technical Assistance Exchange Office
UK	United Kingdom
UNMIK	United Nations Mission in Kosovo
WCEI	Working Committee for European Integration

1. Introduction

For the whole territory of the South Eastern Europe, including Kosovo, the question has never been whether to integrate in to the EU or not but rather a question when and how this integration should be achieved. The EU integration process is a highly complex process which involves the design and implementation of reforms in a wide variety of areas. Experiences from new EU member states as well from those one currently in various phases of their EU integration process clearly indicate that working simultaneously in many areas and taking decisions about complex political, economic, legal and institutional issues with long lasting consequences on the everyday life of the citizens, is far from being an easy task.

As part of the Western Balkan, Kosovo has been given a clear political commitment of the EU to become its member once it fulfils the necessary conditions. How many years this EU accession process will take is difficult to say. Experience of both, new member states as well candidate countries indicate that we are talking about an extremely complex process that requires strong political commitment that will guide the necessary reforms, competent administration that will be able prepare and implement these reform, and last but not least public support that will be ready to accept the necessary changes. Similarly as in all other candidate countries, EU will support these processes with pre-accession assistance. In the past, pre-accession assistance has been provided to EU candidate countries under very different names, but the main objective of this assistance has always been the same, i.e., to support a candidate country in its efforts to meet all the criteria that are needed for the accession to the EU. In the period 2007 – 2013, pre-accession assistance to the pre-candidate and candidate countries of the Western Balkan will be flowing through the so-called Instrument for Pre-accession Assistance –IPA. It is of utmost importance for any pre-candidate or candidate country to create conditions that will allow effective use of resources available under this instrument.

An important segment of the IPA funds are resources available for the so-called cohesion policy³. The fundamental goal of the cohesion policy of the EU is to reduce economic and social disparities between the various parts of the EU. Cohesion policy is being implemented through so-called “internal” instruments, i.e., instruments that are available exclusively to eligible regions within the EU, and through so-called “external” instruments, i.e., instruments that are available to pre-candidate and candidate countries. Within period 2007 – 2013, IPA is the only “external” cohesion instrument of the EU.

This analytical paper has three main objectives:

- To present key patterns of the EU development / cohesion policy and to make a systematic overview of the EU instruments for economic and social development / cohesion, “internal” and “external”, with a special reference to the IPA.
- To outline the concept of the absorption capacity and to analyse actual experiences of two countries – Slovenia and Macedonia – with respect to their absorption capacity.

³ In addition to the term cohesion policy, some other terms, like regional policy, structural policy and policy of structural actions, are used as well. In this text, they are used interchangeably.

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- To discuss administrative / institutional conditions that have to be created in Kosovo in order that it will be effective in tapping IPA cohesion funds throughout its EU accession process.

In addition to this *Introduction*, (Chapter one), the paper consists of five further main chapters and two annexes. *Chapter two* is a kind of a background study. It presents the concept of the EU public finances and provides a systematic overview of key features of the EU cohesion policy in the financial perspective 2007 – 2013, including of the so-called Instrument for Pre-accession Assistance (IPA). This is a financial instrument through which Kosovo will be receiving EU assistance in the next medium-term period. *Chapter three* provides an overview of EU funds flowing into Kosovo until the end of 2006, mainly under the CARDS program, as well as funds available to this territory under IPA in the period 2007 – 2010. *Chapter four* focuses on issues that determine a country's absorption capacity. How successful a county is in actually using allocated EU funds is determined by (i) macro-economic absorption capacity, (ii) financial absorption capacity, and (iii) administrative capacity. *Chapter five* is aimed at providing absorption capacity case studies of two countries at different level of their EU integration process; Slovenia that became an EU member state in 2004 and Macedonia that obtained an EU candidate country status in 2005. *Chapter six* outlines administrative / institutional conditions that need to be created by Kosovo for its effective absorption of EU cohesion funds. As mentioned, there are two annexes enclosed to this analytical paper. The first one summarizes main recommendation of the June 2007 SIGMA reports relevant for introduction of the DIS structure in Kosovo, while the second annex tends to open some options to be discussed in more details what would be needed in order to make such a structure effective.

2. EU policy for economic and social cohesion

2.1. Concept of EU public finances⁴

General facts

The public finance system of the EC, and later on of the EU, has been developing together with the institution itself. The process of European integration, which experienced continuous growth throughout the years, required financial resources for its activities. In addition to the administrative expenditure, there were also costs related to the design and implementation of various policies. The public finance system played an important role in the process of the development of European integration, since it provided the necessary resources, thereby enabling the EC / EU to achieve its goals and objectives as well as fulfil the tasks transferred to it from the national level.

The EC / EU's financial system as known today is a result of numerous changes and adjustments that have occurred over the last fifty years. Despite its modest beginnings, it became indispensable for the functioning of the EC. The importance of financial planning is reflected in the fact, that the negotiations in the financial field are considered to be amongst the most difficult, both between the Member states as well as within the EC / EU itself. In these negotiations, the contributions to, and allocations of expenditure from, the general budget are determined.

The EU budget differs in many aspects from the national public finances of its Member states. Its first and most noticeable difference is undoubtedly its size. Although the budget of the EC / EU has been growing over the years, it is still relatively small in comparison with the public finances of the Member states. Over the last two decades it is capped at 1.24 per cent of the EU's GNI. It needs to be stressed, however, that this is the maximum permitted expenditure, which has never been reached. By comparison, the public finances of the Member states are usually around 40 per cent of their national GNI.

There is a number of reasons for such modesty in the EU budget. First; the EU budget cannot be compared to the budgets of federal states. Nor does it provide for any expenditure regarding sovereign functions, public services and social security as is the case with national budgets. Second, in contrast to national budgets, the EU budget is prohibited from running a budget deficit. In accordance with the provisions of the Rome Treaty, the European budget has to be balanced and may not be in deficit. And third, EU budget expenditures are used primarily to finance its common policies, i.e. for the policies that the member states have agreed will be implemented at the supranational level. This is the explanation why the Common Agricultural Policy and the Cohesion Policy account for almost 80 per cent of total EU budget expenditures.

EU budget has undergone significant changes since the late 1950s. The last major budgetary revision was done in the second half of the 1980 following the EC enlargement with Spain and Portugal and with the conclusion of the *Single Economic Act*. Since then, the EU

⁴ For a detailed and rather technical presentation of the subject, see *European Union public finance*. European Commission, 2002, 410 p.

budgetary system remains more or less unchanged and is composed of two major elements. *First*, the strategic course of the EU public finances and financial framework for the medium-term period is determined in a medium-term financial perspective. And *second*, implementation and operational details of the EU financial plan within the defined medium-term framework are elaborated in the annual budget.

Medium term financial perspective

The medium-term financial perspective is basically an agreement among the EU member states on the budgetary priorities facilitating the budgetary procedure and the management of various programmes. The financial perspective allows financial predictability in the development of EU expenditure. Within the framework of the financial perspective, the maximum volume and the composition of the foreseeable EU expenditure are indicated. The financial perspective fixes the ceilings for particular expenditure headings as well as for the budget as a whole; the cap on spending levels must be set below the own resources ceiling. The financial perspective is a product of an inter-institutional agreement between the European Commission, Parliament and Council. Although it is not a multi-annual budget, and the annual budgetary procedure remains necessary to decide the next year's budget, the financial perspective is not just indicative as it sets the maximum ceilings for each year and each category of expenditure (heading).

Until now, EU institutions have adopted four medium-term financial perspectives. The first one, known as "*Delors I*", covered the five year period between 1988 and 1992 while the remaining three, "*Delors II*", "Agenda 2000", and the so-called "new financial perspective" each covered seven year periods, the first one was 1993 – 1999, the second one was 2000 – 2006, and the third is for the period 2007 – 2013.

In terms of absolute size, total expenditure in the finally agreed 2007 – 2013 medium-term financial perspective for the 2007 – 2013 amounts 864 billion € in commitments or 821 billion € in payments⁵ (these figures compare to 1.025 billion € in commitments or 929 billion € in payments in the Commission proposal). All amounts are expressed in constant 2004 prices. Since the EU budget is balanced by principle, revenue will always match expenditure. In terms of relative size (expressed as per cent of GNI), the EU budget is small. In the 2007 – 2013 medium-term financial perspective, EU budget expenditures expressed in payments are equivalent to 1.00 per cent of EU GNI.

With respect to the expenditure composition, the 2007 – 2013 medium-term financial perspective defines expenditure ceilings for the EU budget under five broad headings: *Heading 1*, Sustainable growth, contains financial support of the EU budget for the Lisbon Strategy and for real convergence of new member states. The corresponding subheadings are *1A*, Competitiveness, which includes parts of former internal policies, mostly R&D, infrastructure and education expenditure, and *1B*, Cohesion, which includes former structural actions, financed by Structural funds and Cohesion fund. *Heading 2*, Natural resources

⁵ Distinction between commitments and payments in the EU budget arises from multi-annual nature of some budget programs (such as cohesion policy, rural development, most of internal and external policies). In these programs, funds committed in a given budget year may be absorbed over several years which gives rise to discrepancy between actual payments and commitments. Payments lag also implies that some outstanding commitments from the current financial perspective will be absorbed in the next financial perspective and that not all commitments in NFP will be used by 2013. As long as EU budget expenditure for multi-annual programs is rising in absolute terms, payments are always smaller than commitments.

basically includes fund for Common Agricultural Policy. *Heading 3* includes the rest of internal policies and new programs promoting freedom, security, justice and European citizenship. *Heading 4* finances external actions of the EU, including the new Instrument for Pre-accession Assistance (IPA), aid to the neighboring countries, and development assistance to third countries. *Heading 5* contains administrative expenditure of European institutions and *Heading 6* transitory budgetary compensations⁶ to new member states.

Table 2.1: Expenditure in the 2000 – 2006 and 2007 – 2013 medium-term financial perspectives

Commitments (2004 prices)	Inter-institutional agreement 2000-2006 (2006 figures)		Commission proposal 2007-2013 (annual average)		Inter-institutional agreement 2007-2013 (annual average)	
	mil €	% of total	mil €	% of total	mil €	% of Total
1 Sustainable growth	45.156	39%	66.313	45%	54.591	44%
1 A Competitiveness	7.570	7%	17.380	12%	10.585	9%
1 B Cohesion	37.586	33%	48.933	33%	44.006	36%
2 Natural resources	55.411	48%	57.182	39%	53.049	43%
CAP (1st pillar)	43.375	38%	43.011	29%	41.872	34%
CAP (2nd pillar)	12.036	10%	14.172	10%	11.177	9%
3 FSJ (3 A) and Citizenship (3 B)	1.119	1%	2.992	2%	1.539	1%
4 EU as a Global Partner	6.222	5%	12.093	8%	7.066	6%
5 Administration	6.499	6%	8.239	6%	7.114	6%
6 Compensation	1.041	1%	0	0%	114	0%
Total	115.448	100%	146.818	100%	123.474	100%

Source: European Commission and authors' calculations

Table 1 shows commitments for the last year of the current financial perspective, which already includes expenditure for 10 new member states, and annual average commitments for the 2007-2013 period based on the Commission proposal and the inter-institutional agreement. In order to make all three proposals comparable, they are expressed in terms of main expenditure headings in the 2007 – 2013 financial perspective.

Annual budget

Comparison between the data contained in the medium-term financial perspective as a strategic document for a particular year and the adopted budget as an operational document for the same year shows that deviations between the adopted budget expenditure and the planned expenditure, as foreseen in the medium-term financial perspective, are minimal and

⁶ The objective of these compensations is to prevent a worsening of new member states' net budgetary balances, following enlargement. New member states were eligible for pre-accession aid before enlargement, however they only started making contributions to the EU budget following the enlargement. Because they are being gradually phased in to the expenditure instruments, this could result in worsening of net balances for some of them in the first few years, following enlargement. In NFP, a similar logic was applied to Bulgaria and Romania.

that the structure of expenditure remains virtually unchanged between the two documents. The medium-term financial perspective therefore de facto determines the structure of expenditure and the total annual budget, even though it is the budgetary procedure, which is required de jure for the adoption of the annual budget and all its details.

Expenditure projected in the medium-term financial perspective, and actually implemented through annual budgets, requires financial resources that are guaranteed to the EU by the so-called Own Resources system. Within this system, the EU can make use of the following three sources of financing: (i) traditional resources, such as customs duties and import levies on agricultural products traded with countries outside the Union; they participate with below 15 per cent in total budget revenue, (ii) contributions based on the value added tax; they also participate with less than 15 per cent in the total, and (iii) contributions from Member states based on the relative size of their GNI; they participate with over 70 per cent in total budget revenues.

A peculiarity of the Own Resources system is the correction mechanism created for the United Kingdom. At the time this mechanism was introduced, the UK had a small agricultural sector with a large proportion of farm produce imported from outside the Community. As a result, very little of the Community's agricultural spending benefited the country while its contribution to the financing of the Community was large. Because of this structural imbalance, a special correction mechanism was instituted, through which a yearly amount for the correction or rebate is calculated. The financing of the UK rebate is distributed among other member states, thereby increasing their contributions. Since 1999, some other EU member states, i.e., Austria, Germany, the Netherlands and Sweden, succeeded that they do not pay their fully their contribution for financing the UK correction.

The power to decide on annual budgetary matters is vested in two EU institutions – the Council and the Parliament. Their rights and responsibilities regarding the budgetary procedure are complementary and are carefully distributed between the two institutions.

The annual budgetary procedure begins with the Commission's presentation of a preliminary draft budget for the coming year based on the Commission's policy priorities, estimates of the EU requirements, expected revenues and the economic outlook. The Commission usually presents this draft at the beginning of May and the Council considers the draft budget for the first time, and modifies the budget as it sees fit. The Council presents its budget proposal at a Budget Council meeting in July.

Once the Council has presented its budget proposal for the coming year, it is time for the Parliament to express its opinion. It analyses the Commission's proposal and the changes made by the Council and presents its budget proposal during its first reading of the budget in late October. After this presentation the Council considers the budget proposal a second time, usually in late November, during which the Council takes a position on the Parliament's first reading of the budget proposal. The budgetary procedure is completed in December, when the Parliament, in its second reading, adopts the budget for the coming year.

2.2. Principles and instruments for implementation of the economic and social cohesion in the 2007 – 2013 financial perspective

An important principle of the EU is solidarity. It is being implemented through the following types of policies:

- Among the member states and in cooperation with the EU-candidate countries the solidarity principle is being implemented through the cohesion policy and by applying “internal” and “external” cohesion instruments. The cohesion policy is aimed at reducing economic and social disparities both (i) between various regions within the EU by using “internal” cohesion instruments, and (ii) between the member states on the one hand and the EU candidate countries on the other by using “external” cohesion instruments.
- The principle of solidarity is also being implemented in cooperation between the EU and third countries. However, in this case, the focus of the EU policy and consequently its financial support to these countries is not cohesion but economic and social development.

As part of the Western Balkan region which does have a clear commitment of the EU member states for their full membership once they meet necessary conditions, Kosovo does have an access to IPA funds. The objective of this assistance is no longer only development as such, this was the case with the CARDS funds, but preparation of the country for EU membership and also, within this context, for the EU cohesion policy. It is for this reason that it is important for Kosovo to get acquainted with the EU cohesion policy and its financial instruments in some significant detail.

Concept of the cohesion policy⁷

The fundamental goal of the cohesion policy of the EU is to reduce economic and social disparities between the various regions in the Community, in accordance with Article 158 of the amended Treaty. Implementation of the cohesion policy consists of a number of development activities, programmes and initiatives of the member states, local authorities and communities, coordinated and co-financed by the EU.

The EU is one of the most prosperous economic areas in the world, but the disparities between and within its member states are striking, even more so when we look at the various regions within the EU. In other words, not all Europeans have the same advantages and chances of success when faced with the challenges of globalisation. It all depends on whether they live in a prosperous or a poorer region, in an area which is dynamic or in decline, in a city or in the country, on the Union's periphery or in one of its economic heartlands. Access to employment, the competitiveness of firms and investments in e-economy technologies are the responsibility of economic operators and national and regional authorities. But these responsibilities are not theirs alone. Solidarity among the peoples of the EU, economic and social progress and reinforced cohesion were all written into the preamble to the Treaty of Amsterdam. Moreover, article 158 of the amended Treaty establishing the European

⁷ In addition to the term cohesion policy, some other terms, like regional policy, structural policy and policy of structural actions, are used as well. In this text, they are used interchangeably.

Community reads: "... the Community shall aim at reducing disparities between the levels of development of the various regions and the backwardness of the least favoured regions or islands, including rural areas". That is why the member states are implementing a European cohesion policy financed by European Funds (the Structural Funds and the Cohesion Fund) which reflects this solidarity between the citizens of the EU.

Overview of EU instruments for implementing economic and social cohesion

EU instruments for implementing economic and social cohesion can be classified into two groups:

- *“Internal” instruments of economic and social cohesion are those instruments that are aimed at supporting cohesion among the EU member states;* The EU cohesion policy permits the transfer of funds which amount to over one third of the Community budget from the wealthy member states to the less prosperous regions and social groups. This approach not only helps the beneficiary countries but also those which are net contributors to the EU budget, as their enterprises profit in return from major investment opportunities and from economic and technological know-how transfers, particularly in regions where various types of economic activity have not yet really taken off.

The following instruments of solidarity, called also “internal” instruments of economic and social cohesion, are used for carrying out the cohesion policy with the EU (in the further text they are also called cohesion policy fund:

- *Structural Funds;* In all the member states, Structural funds exercise a multiplier effect on the economic and social factors likely to stimulate a region's economy. The Structural funds finance programmes of social and economic development in the member states. Over the years these programmes have experienced geographic and social development towards decentralisation of the management structure, a higher level of efficiency and stricter supervision. In the 2007 – 2013 medium-term financial perspective, cohesion policy is being implemented through two Structural Funds, namely ERDF and ESF.
- *Cohesion Fund;* This is a special fund created to assist those member states whose per capita GDP is below 90 per cent of the EU average to develop their transport and environmental infrastructure. While the Structural Funds are oriented towards the regions, the Cohesion Fund provides direct finance for individual projects on a national and supra-national level. The rules of operation of the Cohesion Fund have recently been adjusted so it would achieve higher efficiency.

The main common characteristic of the Structural Funds and the Cohesion Fund is that they are non-refundable transfers to the member states and less developed regions.

- *“External” instruments of economic and social cohesion are those that are aimed at preparing the acceding countries to apply the cohesion policy effectively and efficiently at the moment when they join the EU;* In addition to the cohesion policy within the member states, the EU also offers structural help to the EU-accession states within the framework of programmes of pre-accession support. Pre-accession assistance instruments, in the current medium-term financial perspective this is IPA,

are *de-facto* “external” instruments of economic and social cohesion are aimed at financing various programmes in the fields of infrastructure, industry, environment, services, and small business development. At the same time, these instruments have an objective to prepare a candidate country for an effective use of cohesion funds when they will become full EU member states. The needs of the applicant countries from the Western Balkans are enormous in every respect: institutional building as well as investment in infrastructure, industry, services, small businesses, and the environment.

Basic principles for management of the EU cohesion policy funds⁸

There are six guiding principles for management of the EU cohesion policy funds

- *Concentration*; According to the principle of concentration, the structural operations of the EU are focused mainly on the least developed regions, with the greatest need for the funds.
- *Additionality*; Structural Funds should not be used merely to replace national funds but should supplement existing public expenditure in the member states. The increased EU aid is to result in at least an equivalent increase in total EU and national aid in the member states, taking macro-economic considerations into account. Union funding is always added to national funding so that the country may overcome the limits imposed by its own financial capacity. However, EU funding is not provided as a means for countries to make savings in their own national budgets. The member states bear the main responsibility for the development of areas in difficulty. The EU helps them achieve more and obtain better results than they could achieve acting on their own.
- *Programming*; The allocation of Structural Fund resources is planned and programmed in accordance with medium-term national development plans. Programming, in the sense of planning expenditure over a number of years in order to achieve strategic objectives, has resulted in greater certainty and more stability and coherence in the policy followed and projects funded. The programming process has many stages, which involve a high level of integration and cooperation at various levels, while the decisions become binding for all the parties involved. The programming period has lengthened and is now 7 years.
- *Partnership*; This means the highest possible level of cooperation between the Commission and member states in the design and implementation of programmes. Stronger participation of private sector entities, including the social partners, as well as regional and local authorities in the process of programming and implementation, has led to better targeted and more innovative projects, improved monitoring and evaluation of performance and the wider dissemination of information on their results.
- *Efficiency*; The implementation, monitoring and efficiency of structural operations are primarily the concern of member states. Improving efficiency is one of the main objectives of the new rules regarding the operation of the Structural Funds. The approach to achieving this is by the encouragement of the programmes which have

⁸ It should be underlined that these guiding principles apply strictly for the management of the Structural funds while management of the Cohesion Fund is simplified.

been most successfully managed. A special performance reserve was introduced to ensure the effectiveness of assistance financed by the Structural Funds.

- *Subsidiarity* - The organisation of the Structural Funds is administratively structured according to regional, national and European priorities, whilst the role of the Commission is restricted to the areas where joint decision-making is required.

2.3. Instrument for Pre-Accession Assistance: main patterns and operational implications

Instrument for Pre-accession Assistance, formed through the IPA Regulation⁹, has been designed as a simple, clear and lean instrument, replacing the legal bases previously available in the pre-accession area (PHARE, ISPA, SAPARD, Turkey instrument, CARDS). The IPA is the EU's financial instrument for the pre-accession process for the period 2007-2013. Assistance is provided on the basis of the European Partnerships of the potential candidate countries and the Accession Partnerships of the candidate countries. The IPA is intended as a flexible instrument and therefore provides assistance which depends on the progress made by the beneficiary countries and their needs as shown in the Commission's evaluations and annual strategy papers.

The beneficiary countries are divided into two categories, depending on their status as either candidate countries under the accession process or potential candidate countries under the stabilization and association process, namely: candidate countries: Croatia, Macedonia, and Turkey; potential candidate countries: Albania, Bosnia and Herzegovina, Montenegro, Serbia and Kosovo¹⁰.

The IPA was designed so as to address the needs of the beneficiary countries within the context of pre-accession in the most appropriate way. Its main aim is to support institution-building and the rule of law, human rights, including the fundamental freedoms, minority rights, gender equality and non-discrimination, both administrative and economic reforms, economic and social development, reconciliation and reconstruction, and regional and cross-border cooperation.

To ensure targeted, effective and coherent action, the IPA is made up of five components, each covering priorities defined according to the needs of the beneficiary countries.

The first components concern *all beneficiary countries, i.e. candidate countries and potential candidate countries*:

- *Component I; the "support for transition and institution-building"*, aimed at financing capacity-building and institution-building;
- *Component II; the "cross-border cooperation"*, aimed at supporting the beneficiary countries in the area of cross-border cooperation between themselves, with the Member States or within the framework of cross-border or inter-regional actions.

⁹ Council Regulation (EC) No 1085/2006 establishing an Instrument for Pre Accession Assistance for Macedonia, Croatia, Turkey, Albania, Bosnia and Herzegovina, Montenegro, Serbia and Kosovo.

¹⁰ Kosovo as defined by the United Nations Security Council Resolution 1244.

The other three components are aimed at *candidate countries only*:

- *Component III; the "regional development"*, aimed at supporting the countries' preparations for the implementation of the Community's cohesion policy, and in particular for the European Regional Development Fund and the Cohesion Fund;
- *Component IV; the "human resources development"*, which concerns preparation for cohesion policy and the European Social Fund ;
- *Component V; the "rural development"*, which concerns preparation for the common agricultural policy and related policies and for the European Agricultural Fund for Rural Development (EAFRD) .

Candidate countries are therefore prepared for full implementation of the Community *acquis* at the time of accession, while potential candidate countries are led to progressively align themselves on the Community *acquis*. As for the nature of the measures provided to both groups of countries, the potential candidate countries have access to measures which are similar to those provided under the last three components, but within the framework of the first two components. The difference is in the way these measures are implemented, since for the components preparing for implementation of the structural and agricultural funds the beneficiary country is required to manage Community funds in a decentralized manner.

General IPA political and financial framework¹¹

IPA is the financial assistance element of a broader strategy that aims at modernising societies in beneficiary countries, both with regard to peoples' general living conditions as well as regarding the preparation for and implementation of the EU's *acquis communautaire*. This assistance has to be seen in the political context of the development of relations between the Union and the beneficiary country. As it aims at creating lasting capabilities, the transfer of experiences and know-how should, in case of conflicting targets, ultimately take precedence over the creation of physical goods. In order to deliver this strategic aim, IPA therefore requires close involvement of beneficiary countries' governments throughout the implementation process, starting at the stage of multi-annual programming.

The basic policy document for setting down the priorities for programming will be the European Partnerships (for PCCs) and Accession Partnerships (for CCs), the drafting of which is based on consultation with beneficiary countries. Any update of the priorities of assistance shall be determined in view of the Regular Reports in particular and Strategy Paper contained in the *annual Enlargement package¹²*.

The *Accession partnerships* concluded by the Council with each of the applicant countries bring together in one document the priorities for aid provided by the European Community, the conditions for granting the financing and the priorities for each sector in transposing Community law (the *acquis*). The accession partnerships form the basis for programming pre-accession assistance from Community funds. The Accession Partnerships set out short-tem

¹¹ This sub-chapter is a summary of selected relevant elements from the European Commission, IPA Transitional and Institutional Building Component Programme Guide, 2006 and Commission Regulation (EC) No. 718/2007 of 12 June 2007 implementing Council Regulation No. 1085/2006

¹² Communication from the Commission to the European Parliament and the Council, Enlargement Strategy and Main Challenges 2007-2008, Brussels, 6.11.2007

and medium-term priorities for preparing for EU membership. The Accession Partnerships are regularly up-dated in order to adjust priorities to the countries' specific needs and stage of preparation. Accession Partnerships are presented for: Macedonia, Croatia and Turkey.

European partnerships are drawn up on a regular basis and identify priorities and obligations to be fulfilled by that country. EU financial assistance should be directed to the priorities set out in these partnerships. They guide the reforms in the potential candidate countries by indicating concrete priority actions needed to achieve progress for the short and medium-term. EU assistance is targeted to the Partnership priorities. European Partnerships are presented for: Albania, Bosnia and Herzegovina, Serbia, Montenegro and Kosovo.

The Strategy paper presents the Commission's overall enlargement policy for the candidate countries and the potential candidate countries in a single, annually published document. For each country, the strategy paper takes up progress made, the accession and pre-accession strategy, and support to reforms such as EU assistance and financial instruments. It also outlines a road-map for realising the Western Balkan countries' perspective of EU membership, setting out the stages and the conditions attached to each stage.

The Commission regularly submits to the Council reports on the progress made by candidate and potential candidate countries on their road towards the EU, including implementation and enforcement of EU standards. These reports serve as the basis for the findings and recommendations made by the Commission in the strategy paper and are aimed at allowing the European Council to take decisions on further steps.

*The multi-annual indicative financial framework (MIFF)*¹³ serves as the financial basis for programming of the Community's assistance. It presents an indicative breakdown of the total envelope dedicated to assistance under IPA, by country and by component. The MIFF is established for a three year period. The multi annual indicative financial framework is presented annually to the Council and European Parliament.

The Commission and the beneficiary country shall conclude a *Framework Agreement (FwA)*, which has the power of an international treaty and therefore has supremacy over national (beneficiary country) legislation. In IPA, it forms the basis of the relationship between the Community and the beneficiary country. The FwA is the basis for establishing the necessary institutions within the beneficiary country for receiving IPA assistance (NF, NAO, NIPAC, audit authority, IPA joint monitoring committee and a sectoral co-ordinator for the regional development and human resources components). Furthermore, it lists the conditions for sound financial management of EU assistance, as well as obligations deriving from this. The Framework Agreement also lists the common conditions for full or partial conferral of management of EU assistance to the beneficiary country.

Strategic planning

Multi-annual indicative planning documents (MIPD) ensure the necessary co-ordination and coherence between the different IPA components. They set out, for the country concerned, how the priorities - established in the accession partnership, the *National Programme for the Adoption of the Acquis (NPAA)* or the *National Action Plan*, the enlargement package (regular

¹³ Communication from the Commission to the Council and the European Parliament Instrument for Pre-accession Assistance (IPA) Multi-annual indicative financial framework for 2009-2011 Brussels, 6.11.2007

reports) and the negotiations framework — are translated into specific actions within the relevant IPA components. The MIPD presents areas of interventions and main priorities that the beneficiary country is expected to develop in detail in the programming documents. In doing so, the MIPD ensures the necessary coherence and co-ordination between components

National Programmes are made on the basis of project proposals from the beneficiary country, which take into account the principles and priorities set out in the multi-annual indicative planning documents. Following programming discussions, agreement is reached between the Commission and the beneficiary country on the specific actions to be funded from IPA within the key areas identified in the MIPD. The beneficiary country then submits detailed project fiches.

Based on these fiches, *Financing Proposals (FPs)* are then drawn up each year by Commission services. The FP with its associated project fiches constitutes the key programming document. After inter-service consultation, the FPs are submitted to the IPA Committee for opinion, while the project fiches are submitted to the Committee for information only. Once the IPA Committee has given a favourable opinion, a Financing Decision is taken by the Commission and a *Financing Agreement (FA)* is signed with the beneficiary country, which provides the legal basis for programme implementation. The programme is then implemented as set out in the project fiches, which are the key implementation documents.

Accession to the EU requires an ability by the acceding country to cooperate with other countries pragmatically on fields of common interest. *Regional programmes* are designed to support such initiatives and strengthen multi-lateral experiences in beneficiary countries. *Multi-country programmes* offer support in key policy areas, such as the project preparation facility, support to civil society and customs. There are several ongoing multi-country programmes such as TAIEX, Sigma, Statistics, as well as programmes carried out in association with the EIB, EBRD and CEB involving support for SMEs, municipal finance and municipal infrastructure. Country Co-ordinators should ensure that there is full coherence between national and multi-country programmes in sectors where both types of programme operate and this should be reflected both in the MIPD and the country programme.

Main substantial characteristics of each of the five IPA components

Transition assistance and institution building component (TAIB Component I); The Transition Assistance and Institution Building (TAIB) component applies to both potential candidate countries and candidate countries. In general, the TAIB component assists countries in building up their administrative and judicial capacity. The TAIB component also helps countries fulfil the political, economic and *acquis*-related criteria for membership (the Accession Criteria). Institution building measures and the investments associated with these measures are available to all beneficiary countries. The TAIB component also allows all beneficiary countries to participate in Community Programmes and to prepare for participation in Community Agencies, which form an important aspect of the *acquis communautaire*.

For *potential candidate countries*, the assistance under the TAIB Component aims to foster stabilisation, reconstruction and reconciliation and promote economic and social development throughout the Western Balkans (mirroring the CARDS objectives). As components III, IV and V remain reserved for candidate countries, it is important to note that for the potential

candidate countries under this Transition Assistance and Institution Building component, *access to measures of a similar nature to those under components III, IV and V may be offered.*

For *candidate countries*, the TAIB component mainly supports institution building activities (including investments in regulatory infrastructure) which will prepare candidate countries for taking on the obligations of membership and assist them in the adoption of the *acquis communautaire*.

The TAIB component support to candidate countries differs from assistance to potential candidates in that there is less emphasis on stabilisation and transition and that it aims for full adoption and implementation of the *acquis* rather than a progressive alignment.

There are nine forms of pre-accession assistance for PCCs and CCs. The ninth form is only accessible to potential candidate countries. It consists of investment in economic and social cohesion, investment in regional and rural development and in development of human resources.

*Twinning and Twinning Light*¹⁴ are the main instruments of Institution Building. They are based on co-operation between public administrations in Member states and Candidate Countries and are focused on achieving a mandatory result in terms of the capacity to implement part of the *acquis*.

The nature, scope and content of *TAIEX*¹⁵ assistance have progressively expanded since 1996 to support the approximation of national legislation to EU law, and its implementation and enforcement. TAIEX activities include seminars, workshops, expert mobilisations and study visits, the provision of tools and information products for amongst others, translation and interpretation activities and co-ordination and monitoring in close co-operation with Member states and Commission services.

During programming, a careful analysis should take place whether institution building is better delivered through *Twinning* or *Technical assistance (TA)*. Programming should give preference to *Twinning*, as the best means of transferring expert know-how from the public sector, delivering IB assistance, but TA (involving commercial consultants, universities, NGOs etc.) may be used where *Twinning* is not appropriate.

Assistance may also, in exceptional circumstances, be delivered in form of *budgetary support*. This support aims at redressing structural problems that are central for the success of the objectives of EC assistance in a specific sector, for example the reform of a pension system. Such assistance requires precise objectives and related benchmarks to be closely monitored, possibly involving other Commission DGs.

Substantial support, in close association with soft IB, is needed for the *supply of equipment (investment in Acquis)* which directly assists an institution to carry out its function (generally of monitoring compliance) for a part of the *Acquis*.

¹⁴ European Commission *Twinning Brochure*, 2006

¹⁵ Technical Assistance Exchange Office is part of DG Enlargement and one of the most powerful instruments for acceleration of the harmonisation process and alignment with the *Acquis*

Grants schemes-Civil Society under IPA component I will aim at contributing to the consolidation and broadening of political reforms and EU alignments and to the strengthening of contacts and mutual exchange of experience between civil society in the Member states and the beneficiary country. Political parties are excluded from funding.

Support to Potential Candidate Countries in Economic and Social cohesion, Regional, Human Resources and Rural Development (IPA III, IV and V-type of assistance) - Investment support and Grant schemes. For potential candidate countries, IPA foresees support to policy development and investment in the areas of economic and social cohesion, including, but not only, bridging towards regional and human resources and rural development policies applicable upon accession. By doing so, PCCs can benefit from measures similar to those foreseen under IPA Components III, IV and V for CCs, but without the management requirements that apply to these components. The following objectives can be supported on the basis of clear-cut government strategy:

- Assistance to *policy formulation and build-up of administrative capacities* should be provided for each objective as necessary.
- Improving *infrastructure* central for enhancing economic activity and social cohesion, including at local and regional levels, contributing to regional development.
- Improving *environmental standards*, including through co-financing of infrastructure, with particular attention to strengthening the polluter-pays principle and addressing cross-border effects (internalisation of external effects).
- Strengthening *rural development*, by enhancing conceptual-, strategic programming- and implementation capabilities, by supporting measures to strengthen production, processing and distribution, as well by fostering economic diversification in rural areas.
- Strengthening *human resources development* (European Social Fund-type activities), e.g. to support employment and social inclusion.

Cross-border co-operation component (CBC Component II): The cross-border co-operation component shall provide assistance to cross-border co-operation between one or more Member states and one or more beneficiary countries as well as to cross-border co-operation between two or more beneficiary countries.

The Community assistance shall be aimed at strengthening cross-border co-operation through joint local and regional initiatives, combining both external aid and economic and social cohesion objectives.

The cross-border co-operation component may also support, where appropriate, the participation of eligible regions of the beneficiary countries in trans-national and interregional programmes under the European territorial co-operation objective of the Structural Funds and in multilateral sea basin programmes.

For the purposes of cross-border co-operation, *the eligible areas* for financing shall be as follows:

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- NUTS¹⁶ level 3 regions or, in the absence of NUTS classification, equivalent areas along land borders between the Community and the beneficiary countries;
 - NUTS level 3 regions or, in the absence of NUTS classification, equivalent areas along maritime borders between the Community and the beneficiary countries separated, as a general rule, by a maximum of 150 kilometres, taking into account potential adjustments needed to ensure the coherence and continuity of the co-operation action.

The regional development component (RD Component III); It may support operations under the following priorities: transport infrastructure, in particular interconnection and interoperability between national networks, and between national and trans-European networks; environment measures related to waste management, water supply, urban waste water and air quality; rehabilitation of contaminated sites and land; areas related to sustainable development which present environmental benefits, namely energy efficiency and renewable energy; operations which enhance regional competitiveness and a productive environment, and encourage creation and safeguarding of sustainable employment, involving in particular:

The human resources development component (HRD Component IV); It shall contribute to strengthening economic and social cohesion as well as to the priorities of the European Employment Strategy in the field of employment, education and training and social inclusion. In particular, the scope of this component shall cover assistance to persons and focus on increase adaptability of workers, enterprises and entrepreneurs, enhance access to employment and sustainable inclusion in the labour market of job seekers and inactive people, prevent unemployment, encourage active aging and prolong working lives expand and enhance investment in human capital.

Beneficiary countries shall establish, based on the multi-annual indicative planning document, a strategic coherence framework to be discussed with the Commission. *The Strategic coherence framework* shall constitute a reference document for the programming of the regional development component and the human resources development component.

Rural development component (Component V); Assistance under *the Rural Development Component* shall contribute to improving market efficiency and implementation of Community standards; preparatory actions for implementation of the agri-environmental measures and local rural development strategies; development of the rural economy.

Assistance covering above objectives shall be granted through the investments in agricultural holdings to restructure and to upgrade to Community standards; support for the setting-up of producer groups; investments in the processing and marketing of agriculture and fishery products to restructure those activities and to upgrade them to Community standards; actions to improve the environment and the countryside; preparation and implementation of local rural development strategies; improvement and development of rural infrastructure; diversification and development of rural economic activities; improvement of training.

¹⁶ Nomenclature of Territorial Units for Statistics (NUTS) level 3 are eligible for Cross Border Cooperation IPA assistance

*IPA Management and control systems*¹⁷

The central point of IPA is not “to get a job done”, but to transfer know-how and experience to partner countries. During the lifetime of this instrument, it is therefore expected that decentralized management will be the norm also for potential candidate countries. However, initially potential candidate countries will be under centralised management, with the clear focus on assisting countries to gradually taking on more responsibility and in progressing towards decentralised management.

Each country should therefore have specific strategies, action plans and timetables in place for moving towards more decentralisation, while at the same time preparing national authorities to take on board and have adequate capacity for the increased responsibilities related to this.

In principle, fully decentralised management, i.e. decentralised management with ex-post rather than ex-ante control (meaning EDIS in PHARE/ISPA terms), should be pursued wherever possible, dependent on the administrative capacities of individual recipient countries, and should be considered the ultimate objective.

Centralised management can take the following forms:

- *Centralised direct management* in the form of implementation by the Commission services at Headquarters;
- *Centralised deconcentrated management* in the form of implementation by the Commission Delegation in the beneficiary country;
- *Centralised indirect management* in the form of implementation through Community agencies, Community bodies or national public sector.

Decentralised Management System (DIS) involves the transfer of responsibility from the Commission to the Contracting Authority of the recipient country. The Contracting Authority becomes responsible for the tendering and contracting, as well as the financial and administrative management of the projects.

Before deciding to confer management powers relating to a component, a programme or a measure on the beneficiary country, the Commission shall satisfy itself that the country concerned meets the conditions; in particular as regards the management and control systems established, and that the accreditations are in force.

The competent accrediting officer shall be responsible for the accreditation of the national authorising officer. The accreditation of the national officer shall cover the national fund. The national authorising officer shall be responsible for the accreditation of the operating structures. The national authorising officer shall notify the Commission of the accreditation of the operating structures and shall provide all relevant supporting information required by the Commission, including a description of the management and control systems.

Before the conferral of management powers, the Commission shall review the accreditations referred and examine the procedures and structures of any of the bodies or authorities concerned within the beneficiary country.

¹⁷ Commission Regulation (EC) No. 718/2007 of 12 June 2007 implementing Council Regulation No. 1085/2006

Decentralisation without *ex ante* controls by the Commission shall be the objective for the implementation of all IPA components where assistance is implemented on a decentralised basis. The timing for attainment of this objective may vary depending on the IPA Component concerned.

In order to put in place a complete DIS, a specifically designed structure is needed. The beneficiary country shall designate the following different bodies and authorities:

- a national IPA co-ordinator (NIPAC),
- a sectoral co-ordinator for the regional development component and the human resources development component (SCO) ,
- a competent accrediting officer (CAO),
- a national authorising officer (NAO),
- a national fund (NF),
- an operating structure by IPA component or programme (CFCD and SPOs),
- an audit authority (AA).

3. EU assistance for economic and social cohesion available to Kosovo

3.1. Evolution of the assistance till 2006¹⁸

Community assistance to Kosovo has been provided since 1998 under a variety of instruments including regular technical assistance, humanitarian aid, exceptional financial support and financing to Pillar IV of UNMIK¹⁹. Since 2000, the CARDS programme has been the main financial instrument for Kosovo, with programmes mainly implemented by the European Agency for Reconstruction.

To date, EU assistance including the EU Member states assistance amounted to 2.6 billion € Out of this total, EC assistance accounts for almost 1.8 billion € in the period since 1999 and included (i) CARDS and other EC support 1,174 million €, (ii) support to UNMIK Pillar IV 126 million €, (iii) exceptional financial assistance (including budgetary support) 115 million € and (iv) humanitarian assistance (for the period 1999-2002) 378 million.

In the post-conflict phase, an urgent physical infrastructure and stabilization programme was initiated. This included: the reconstruction of over 16,000 houses; the rehabilitation of water and sanitation systems; the irrigation of over 10,000 hectares of farm land; the repair of over 400 km of road and 16 bridges; the completion of municipal infrastructure projects; and the construction of six regional landfills to EU standards and Kosovo's first wastewater treatment plant. However, there is still a significant need for infrastructure support in Kosovo.

Major investments (over €400 million of EC investments) supported the rehabilitation of Kosovo's dilapidated energy sector. EC funds have supported emergency electricity imports and the large-scale over-haul of the Kosovo B power plant, the coalmines, transmission systems, distribution networks, and district heating plants. EC assistance also targeted management and capacity building in energy sector and assisting Kosovo's participation in Energy Community for South East Europe. However, the outstanding investment needs are much larger, as is the need to support sound corporate management to ensure the viability and sustainability of the sector.

EC assistance has gradually evolved to reflect and support Kosovo's participation in the *Stabilization and Association Process*, to fulfill European Partnership priorities and in support of the implementation of the UN Standards for Kosovo. In partnership with the government, UNMIK, EU Member states, IFIs and other donors, on-going assistance focuses on: strengthening the rule of law; building the technical skills and capacity of the PISG-Provisional Institutions of Self Government (Kosovo assembly, ministries, and municipalities) to formulate and implement coherent policy reforms, strategies and EU compatible legislation and to fulfill their expanding mandates. Economic development and creating sustainable jobs for Kosovo's communities; supporting the return and durable integration of minorities was another priority area for support.

Kosovo also benefits from the CARDS regional programme to support actions of common interest for the Western Balkan region, for example in the fields of infrastructure, institution building, higher education (e.g. Tempus) and cross-border cooperation. However, Kosovo's possibilities and capacities to fully participate in regional programmes were limited hitherto.

¹⁸ Office for South East Europe European Commission/World Bank Brussels, Donor Polling for Kosovo (Under UNSCR 1244), March 31, 2006

¹⁹ UNMIK - United Nations Mission in Kosovo

Given the importance of regional cooperation, an objective is to further support Kosovo's full participation in regional activities of Western Balkans, including cross-border cooperation with neighboring areas.

Past assistance has contributed to stabilizing Kosovo. However, continuous well-focused and coordinated assistance is needed in order to create the conditions for sustainable political and socio-economic development after the status settlement. Experience with previous EC assistance has shown that the future assistance under IPA needs to consider the following *lessons learnt*²⁰:

- EC assistance must be interlocked with Kosovo's development and action plans, e.g. the action plan for the implementation of the European Partnership priorities and *Kosovo's Development Strategy and Plan* (KDSP), including sectoral strategies and plans. Projects, which do not comply with strategic documents, should be rejected or included in programmes only in exceptional cases.
- A precondition for efficient assistance is coordination. This will require increased efforts of Kosovo's institutions to articulate a link between their development needs and EC assistance, efficient donor coordination and improved cooperation within the PISG. Kosovo's IPA coordinator will be responsible for the coherence and complementarity of IPA assistance internally and with other donors. Kosovo's Action Plan for the implementation of the European Partnership will specify the sub-sectors where IPA assistance can be used and how it would match with financing from other donors and Kosovo's budget.
- Increased local ownership of EC assistance to Kosovo is essential for the effective targeting of that support, and achieving the agreed results in line with EU standards. Therefore, the planning and project preparation capacity of Kosovo's authorities has to be improved. A targeted and continuous institution building assistance should be planned in programmes.
- As Kosovo moves closer to Europe and *acquis* approximation becomes more and more pertinent, the administrative and financial implications of *acquis* approximation to the Kosovo administration must be considered in delivering technical assistance and its sequencing need to be seen in the light of scarce budgetary resources.

The administration's *absorption capacity* must also be taken into account when designing technical assistance programmes in order to allow maximum benefit of assistance provided. In this context, targeted support to the improvement of human resources management and development in the Kosovo's administration should be considered. It is important to develop internal evaluation mechanisms for institutional capacity assessment in Kosovo administration.

A number of EU Member states, international financing institutions, other organizations and bilateral donors are active in Kosovo. Close coordination and division of tasks with other donors is ensured during the annual programming process.

The European Agency for Reconstruction manages a cumulative portfolio of some €1.1 billion in different projects and programmes across Kosovo, above 93% of which has already been contracted. In 2006, the Agency continues to assist the government, the Assembly and the

²⁰ Commission Decision of 01/06/2007 on a Multi-annual Indicative Planning Document (MIPD) 2007-2009 for Kosovo under UNSCR 1244 and MIPD

municipalities in drafting and implementing coherent policies, strategies and EU-compatible legislation. Here are some of the highlights of the Agency's work:

- *Building institutional capacity:* Assisting Kosovo's institutions in developing technical competencies to manage reforms mandated by the SAA process and the European Partnership
- *UN Standards for Kosovo:* The Agency continues to work with the government and the municipalities to assist them in achieving the Standards for Kosovo.
- *Minority Returns:* Assisted the return of some 220 Serb and Roma families through multi-sector projects involving housing construction and rehabilitation of social infrastructure.
- *Access to Justice:* Some 31.000 people from all of Kosovo's communities have received legal aid in civil and administrative matters as a result of an EC-funded programme.
- *Public Finance:* Assisted the Ministry of Economy and Finance to develop the first Public Investment Programme, which includes over 1.500 public investment projects.
- *Generating Jobs:* Collaborating with the EBRD in providing expert management advice to enterprises for business expansion and development.
- *Energy:* Assisting the energy utility KEK to benefit from its participation in the Energy Community for South East Europe and improve its revenue collection.

The Agency had its roots in the aftermath of the Kosovo war. In early 2000, it took over from the European Commission Task Force for the Reconstruction of Kosovo. EAR initially focused its assistance on the rehabilitation and repair of key infrastructure and public utilities. It concentrated on energy, housing, transport and water supplies. It also supported enterprise development, agriculture, health and institution building.

By 2002, the emphasis gradually shifted to institutional capacity building and development of market economy. Supporting for critical infrastructure needs continued, albeit at a reduced level. In 2003 the Agency's priorities moved towards public administration reform at central and municipal levels as well as support to the police and judiciary. Economic stabilisation and employment regeneration were the other key focal areas, together with environmental issues and support to civil society. The 2004 programme focused on paving the way for investments from international financial institutions, promoting good governance and the rule of law. Job training remained an important component of the programmes in almost all sectors.

3.2. IPA funds for the post 2006 period

Pre-accession Assistance Strategy for the Period 2007-2009

When designing the *Multi-annual indicative planning document (MIPD)*²¹, Kosovo's general strengths, weaknesses, opportunities and threats should be considered. EC assistance is drawing on Kosovo's *strengths*: its young population, with its motivation linked to Kosovo's future status and integration into the region. The basic regulatory framework for the establishment of a market economy is in place, privatization has progressed and a Kosovo Development Strategy and Plan (KDSP) is being prepared. Among the *weaknesses* that must

²¹ Commission Decision of 01/06/2007 on a Multi-annual Indicative Planning Document (MIPD) 2007-2009 for Kosovo under UNSCR 1244 and MIPD

be considered: the need to fully provide all communities the same opportunities, deficits in the respect for the rule of law, the lack of institutional capacity, high unemployment and low wages.

Kosovo must seize the *opportunities* such as natural resources with a high potential for domestic and foreign direct investment and the willingness of the European Union and the international donor community to provide financial assistance as well as facilitating regional and cross border cooperation in the context of its European perspective. However, difficult relations with Belgrade and other neighbors, rampant corruption and organized crime are *threats* to the realization of the aims of EC assistance which need to be taken seriously in consideration.

Kosovo authorities are currently proceeding with an assessment of EU compatible sector reforms and financing needs with the preparation of a *Kosovo Development and Strategy Plan (KDSP)* and *Medium-Term Expenditure Framework (MTEF)* which will include a long-term vision, a macroeconomic framework 2007-2013, sector policies, priority projects in the period 2007-2009 and an action plan. This package of documents should be used by authorities as a base for further planning and programming.

The objectives of the *European Partnership*, lessons learnt from past and on-going donors' assistance (EU and other), and analysis of the current situation and challenges ahead have informed the strategic choices for Kosovo made in this multi annual indicative planning document.

- *First*, EC assistance will support Kosovo in developing the reforms necessary to promote a modern, democratic, multi-ethnic and well administered society and in support of the implementation of the Kosovo's status settlement.
- *Second*, developing Kosovo's economy and enhancing the wider socio-economic and institutional environment will be a priority of this MIPD.
- *Third*, assistance to prepare a comprehensive European reform agenda, e.g. by paying special attention to addressing needs and priorities identified in the last progress report, the European Partnership and in relation to wider EU sectoral approximation.

All IPA activities programmed for Kosovo should be closely coordinated with other EC sponsored cooperation activities and multi-beneficiary programmes. The continued aim is to integrate Kosovo fully into the region and implement regional strategies (e.g. in areas of infrastructure, justice and home affairs, public administration reform, including TAIEX, strengthening civil society, education, youth and research, and market economy) at local level.

EC financed cross border cooperation is new to Kosovo but it is recognized as crucially important for stability, good neighboring relations and socio-economic development of peripheral communities. The aim of EC assistance will be to develop local administrative and project management capacity in Kosovo's border regions and also identify the pipeline of local development projects. Development of cross-border cooperation is dependent on general capacity building activities of authorities responsible for regional policy. The institution building activities under IPA components I and II will also have as an objective to generate additionality, complementarity, and catalytic effects between components.

Table 3.1: Multi Annual Indicative Financial Framework for Kosovo, allocations for the 2007 - 2011 period (in million €)²²

IPA	2007	2008	2009	2010	2011	TOTAL
Transition Assistance and Institution Building	68,3	122,0	63,3	64,5	65,8	383,9
Cross-border Cooperation	0	2,7	2,7	2,8	2,8	11,0

European Partnership as Guidelines for Kosovo policies and priorities

The objective of the *European Partnership*²³, as instrument of the Stabilization and Association Process, is to provide a general reference framework for the priority areas for reform and further action, which are identified according to the country's needs and involve the adoption and/or implementation of appropriate legislation and the guidelines for financial assistance for action in these priority areas. European Partnership is a flexible instrument designed to highlight the efforts that still need to be made in the areas as identified by the Commission's assessments. The priority objectives set in the European Partnership are both realistic and attainable. In this regard, a distinction is made between short-term and medium-term priorities, which are expected to be achieved within one to two years and within three to four years respectively.

In order to guarantee a secure, *democratic and multi-ethnic Kosovo*, its priorities fall into the following categories:

- *The key priorities (the most important)*: relates to respecting the rule of law, democratic governance, the provision of public services, setting up a transparent and accountable public administration and continuing reforms of local self-government. They also promote respect and tolerance between the communities in order to encourage people to return. The fight against corruption, organized crime and terrorism must be continued. Favorable conditions must be created for investment, trade, employment and economic growth. Full cooperation with the International Criminal Tribunal for the former Yugoslavia (ICTY) and compliance with UN Security Council Resolution 1244 are essential.
- *Political requirements*: relates to democracy and the rule of law (provisional institutions of self-government, public administration, elections, the judiciary, witness protection and combating corruption), human rights and the rights of minorities (ombudsman, the return of refugees and displaced persons including strengthening the ministry responsible and developing a joint strategic framework, reintegrating Roma communities, respecting the official languages, mechanisms for protecting human rights and the rights of minorities, participation by all communities, preserving cultural heritage, legislation on public broadcasting and media self-regulation, a legal framework for NGOs, protecting property rights, combating discrimination, gender equality and all forms of violence against women). They also focus on regional issues and international obligations (strengthening

²² Extract from the Communication from the Commission to the Council and the European Parliament Instrument for Pre-accession Assistance (IPA) Multi-annual indicative financial framework for 2009-2011 Brussels, 6.11.2007

²³ Proposal for a Council Decision on the principles, priorities and conditions contained in the European Partnership with Serbia including Kosovo as defined by United Nations Security Council Resolution 1244 of 10 June 1999 and repealing Decision 2006/56/EC (presented by the Commission), Brussels, 6.11.2007

regional cooperation and good-neighborly relations, regional and international cooperation on law enforcement, and implementing regional free-trade agreements.

- *Economic requirements:* covers the privatization process, the restructuring and incorporation of publicly owned enterprises, restructuring public utilities, the sustainability of public finances, defining and applying macroeconomic and budgetary priorities in cooperation with the International Monetary Fund, budgetary discipline and control of public spending, developing the capacity of the banking sector, developing a framework to guarantee investments, developing a framework for trade and trade-related policies, flexible social policies to promote employment, social cohesion, combating poverty and social exclusion, and improving the quality of education and training). Furthermore, in conjunction with the sectoral strategies, a medium-term development plan and strategy should promote economic development while taking into account the needs of the fight against poverty, the expenditure framework and the public investment programme.
- *European standards:* relates to certain aspects of the Community *acquis*, i.e. the internal market (free movement of goods and capital, customs and taxation, public procurement, intellectual property law and statistics), sectoral policies (industry and SMEs, rural development, the environment, transport, energy, the information society and the media, and financial control) and the area of justice, freedom and security (visas, border control, asylum and immigration, money laundering, drugs, police, and combating organized crime and terrorism). In these areas, Kosovo must endeavor to bring its legislation into line with the Community *acquis* and ensure its implementation. Kosovo must also develop and strengthen its administrative capacity in order to ensure that its policies and legislation are coherent with EU requirements and to implement EU standards.

Kosovo European Partnership Agenda

Everyone should be aware that any further development of Kosovo (progress) will be measured through implementation of the Key, short-term and mid-term priorities of the European Partnership. Exactly because of the political heaviness of the European Partnership and correct understanding by the Government, the adequate answer to all this requirements in a form of a *European Partnership Action Plan*²⁴ (EPAP), is in advanced preparation. Agency for European Integration is responsible for preparation of the EPAP and monitoring of its implementation.

EPAP is a very practical document serving as a tool that should always answer/consider if there is a need for Political decision, if there is a need for legal intervention-Legislation, if there is a need for institutional interventions, if there is a lack (and where) of administrative capacity, if there is a need for procurement of equipment, if there is a need for capital investments.

The EPAP has a great value and can (should/could) be used for streamlining internal and external communication. For internal communication streamlining the relations between the Prime minister and international community, the Prime minister and the government members, Ministers and there ministerial staff, relations among the government bodies , Government and business community and with the social partners , relations with the NGO sector, Communication with the media, and with wider public, all citizens. For external communication, Communication with international community and better understanding of

²⁴ The process of preparation of the European Partnership Action Plan 2008 is in progress, lead by the Agency for European Integration involving all relevant Kosovo institutions

Kosovo priorities, relations with European Commission and with all EU member states, with Kosovo neighbors, with European academic and nongovernmental sector and wider public.

Action Plan should be used as well for planning of almost all Government activities, like those related to the Political agenda of the Government and its priorities, Legislative agenda for the Government (Laws, Sub legislation, Decisions and other legal acts) and for the Parliament, plan for recruitments needed for implementation of European integration agenda and enforcement of the harmonized legal acts, plan for institutional building and training of the staff (general and specific training needs), and plan for investments and particularly for IT network building (upgrading) related to the *acquis*.

4. Absorption Capacity Concept

4.1. Concept of the absorption capacity and its determinants

Within the context of the EU's public finances, absorption capacity is defined as the extent to which a state (member or non-member) is able to spend the allocated financial resources fully and in an effective and efficient way. With the experiences gathered over time, the European Commission has arrived at the conclusion that states have a limited capacity to absorb external investment support effectively and efficiently.

The absorption capacity for cohesion purposes has three main determinants: (i) the macro-economic situation; (ii) the co-financing situation; and (iii) the administrative capacity. In the following paragraphs, all three aspects of a country's absorption capacity are presented in some detail.

- *Macro-economic absorption capacity*; Within the context of the EU, macro-economic absorption capacity is defined and measured in terms of GDP. Experience gathered over time has led the European Commission to arrive at the conclusion that EU member states have limited macro-economic capacity to absorb external investment support effectively and efficiently. During the 2007 – 2013 medium-term financial perspective of the EU, the upper limit for EU cohesion purposes has been set at 3.6 per cent of the GDP of the respective country, and the same figure has also been proposed by the Commission for the next medium-term financial perspective²⁵.
- *Financial absorption capacity*; Financial absorption capacity can be defined as the ability to co-finance EU supported programmes and projects, to plan and guarantee these national contributions in multi-annual budgets, and to collect these contributions from multiple partners involved in a particular programme or project.
- *Administrative / institutional capacity*; Administrative absorption can be defined as the ability and skill of central and local authorities to prepare suitable plans, programmes and projects in time, to select programmes and projects, to arrange the co-ordination among principal partners, to meet the administrative and reporting requirements, and to finance and supervise implementation properly, avoiding irregularities as far as possible. Administrative capacity of the country is, in fact, composed two components:
 - On the *demand side*, administrative capacity is determined by the ability of potential project applicants to generate projects.
 - On the *supply side*, this capacity is determined by the ability of the country to manage the Structural Funds efficiently and effectively. The utilisation of Structural Funds is determined by the *design variables*, such as structure, human resources and tools, related to the specific EU requirements. For the Structural Funds, these *requirements* are largely incorporated in the Structural

²⁵ The Commission has been using various models for assessing impacts of the Structural Funds inflows on macro-economic aggregates, like GDP growth and employment, of the member states. One of models very frequently used for this purpose is the HERMIN model.

Funds regulations. Therefore, changes in design and requirements will have their impact on the utilisation of funds, and ultimately on the absorption capacity of the country. Measuring the supply side of the administrative capacity starts with an analysis of three design variables:-

- *Structure* relates to the clear assignment of responsibilities and tasks to institutions, or more precisely, at the level of departments or units within these institutions;
- *Human resources* relate to the ability to estimate the required number and qualifications of staff, to allocate tasks and responsibilities to the job descriptions of particular posts, and to meet these needs through the recruitment of appropriate staff.
- *Tools* relate to the availability of various kinds of job-aids, including instruments, methods, guideline, manuals, systems, procedures, etc., that can enhance the effectiveness of the functioning of the system.

4.2. Absorption capacity experiences of the new member states in their pre-accession period

Macro-economic absorption capacity

The 10 candidate countries that joined the EU in May 2004 had never been in a situation to receive EU budget resources equivalent to about 4 per cent of their respective national GDP, which is the ceiling for the member states according to the *acquis*. Before the 2004 EU enlargement, the largest recipients of EU funds among the candidate countries, expressed as a percentage of GDP, were the three Baltic countries. In 2003, the last full pre-accession year, they received the equivalent of around 0.8 per cent of their GDP in the form of pre-accession assistance²⁶ from the EU budget. There is no doubt that these resources were significant for the three countries but they were far below the *acquis* ceiling of 4 per cent of their GDP. The figures were, of course, much lower for other, more developed accession countries. For Slovenia, for example, EU pre-accession assistance was less than 0.2 per cent of the country's GDP in 2003.

The above figures clearly indicate that macro-economic absorption capacity was not a constraint for effective and efficient use of EU resources allocated to these countries in the form of pre-accession aid channelled through PHARE, ISPA and SAPARD instruments.

Financial absorption capacity

In order to increase the incentive for their efficient use, EU structural assistance only finances a part of the total costs of a programme or a project, which means that there is a need for national co-financing. Such national co-financing requirements have existed not only for the member states eligible to use Structural Funds and the Cohesion Fund but also for the EU-

²⁶ Pre-accession assistance figures were taken from Copenhagen Council tables and GDP figures from the Transition report update prepared by EBRD in April 2004.

candidate countries eligible to use the IPA funds. The standard national co-financing rate is around 25 per cent.

In 2003, i.e., in the last full year before EU accession, the expected inflow of the pre-accession funds to the EU-candidate countries was between 0.2 per cent of GDP in the case of Slovenia and 0.8 per cent in the case of the Baltic States. If a 25 per cent co-financing rate is applied, the total amount required for national co-financing can be roughly estimated at a level equivalent to 0.07 per cent of Slovenia's GDP and 0.26 per cent of the Baltic states' GDP. As the investment portion of the central government budget in a country typically accounted for at least 2 per cent of GDP, this clearly indicates that national co-financing of EU funded programmes and projects represented a relatively small proportion in this segment of the central government budget.

Consequently, financial absorption capacity, i.e., the ability to provide national co-financing, was not a major concern for absorption of EU funds of the pre-accession countries in the years before they joined the EU.

The demand side of administrative / institutional absorption capacity – project pipeline development

The level of economic development in the EU candidate countries was generally very low in comparison to the member states. With the exception of a few smaller countries – Cyprus, Slovenia and Malta – their per capita GDP in PPP terms was around half of the EU average, and in some cases even lower. While the investment needs of these countries were, and still are, very large, the number of well prepared investment and institutional building projects ready for execution continues to be small. The experiences of the new EU member states during the pre-accession period show that the problem was particularly difficult at the regional level, where regional authorities were required to programme substantial volumes of resources through structures which had, in many cases, only been recently put in place.

EU-candidate countries were typically faced with the challenge of preparing a number of mature, high quality projects sufficient to absorb the greatly increased volume of EU funds which would become available after accession. The scale of this challenge varies with the size and the type of projects. Large projects typically require several years of preparation before project proposals can reach the point where they can be approved for EU assistance. Smaller and less complex projects, on the other hand, can be prepared in shorter periods of time. There are also significant differences in project preparation for different types of projects. The preparation of infrastructure projects requires different inputs than the preparation of projects aimed at either increasing competitiveness or at improving human potential.

In order to develop a good list (pipeline) of potential projects, authorities have to be very proactive. It is primarily a responsibility of the countries themselves to design a detail programme of activities in this area, to provide adequate resources, especially financial resources and sufficient trained personnel, to ensure that the best use is made of the available funds.

Experiences show that not all acceding countries have fully appreciated the difficulty and complexity of developing a project pipeline to ensure that full use is made of available resources. This can be clearly confirmed by the fact that activities financed by the Commission aimed at strengthening project generating capacity in these countries often fell

short of expectations. In some cases, the money available for project preparation purposes was simply not contracted.

Establishing an adequate pipeline of projects is important, but it is only a part of the early stage of the project life cycle. The pre-accession experience has shown that the implementation of projects after their approval has in the past proved to be weak, and therefore requires special attention by national authorities.

The supply side of the administrative / institutional absorption capacity

The supply side of the EU-candidate countries' administrative / institutional absorption capacity will be assessed through the five phases of the policy life cycle: (i) management; (ii) programming; (iii) implementation; (iv) evaluation and monitoring; and (v) financial management and control.

Phase no. 1 – management; Management is a key issue when assessing the administrative capacity of a country to absorb EU cohesion funds. It basically deals with the allocation of responsibilities and tasks and the key institutions are the MAs.

Experience shows that there is no standard model for MAs in the EU member states and, therefore, EU-candidate countries do not have a clearly specified model to follow. What has to be underlined here is that the designation of MAs is an extremely important decision, as this assignment is in fact a precondition for further preparation, including staffing, training and development of the necessary systems and tools, both for the MAs and also for other bodies.

The first crucial issue is the organisational location of MAs in relation to the governance structures. This has to be decided having regard for the specific circumstances in the country concerned, reflecting existing administrative structures, planning traditions, the distribution of power between different elements of the governance structures and the size of the country.

The responsibilities of the MAs are in the fields of programming, implementation, monitoring and evaluation as well as financial management and control. Although some these responsibilities may be shared with other bodies, the MAs carry finally responsibility.

The EU candidate countries have sometimes focused on quantitative requirements in terms of the numbers of staff required for the efficient operation of MAs. Experience in the old Member states, however, demonstrates that effective and efficient management of the Structural Funds' resources depends heavily on having highly qualified and motivated staff. The preparation of detailed organisation schemes and job descriptions has also proved to be essential.

Phase No. 2 – programming; The Structural Funds of the EU may be channelled to eligible countries and regions on the basis of multi-annual programmes that provide a conceptual framework for their financial interventions. According to appropriate regulation adopted for each medium-term financial perspective, such a programme should typically contain: (i) a statement of the strategy and priorities for joint Community and national action; and (ii) a summary of the measures for the implementation of priorities, an indicative financing plan and provisions for implementation.

In principle, there are two approaches to organising the programming process in a country. *Firstly* the bottom-up approach, based on a partnership with regions and sectors, whose main advantage is that it typically reflects well the real needs of these players. *Secondly* the top-down approach, which is typically better not only with respect to the overall consistency of the programme, but also in ensuring that its measures and priorities are aimed at achieving the programme's objectives.

Experience in the pre-accession countries indicates that the programming process is a demanding exercise. It is not only a very labour intensive process that takes a lot of time, but it is also a process that requires a lot of inter-ministerial coordination. Strategic documents that had to be prepared by the new member states for the 2004 – 2006 period – National Development Programmes, Community Support Frameworks, Single Programming Documents – have often lacked a coherent strategic framework due to difficulties in organising an effective inter-ministerial co-ordination process. This is also illustrated by the potentially overlapping and unfocused description of the priorities and measures. It is of crucial importance that the financial, and more specifically budgetary, aspects of programming are introduced into the process at a very early stage. If not, the documents may easily turn into a kind of a “wish-list” that does not correspond with the actual financial capacity of the country.

The inter-ministerial coordination required in the programming process is closely connected to the issue of partnership, although the latter issue is a much broader one. It involves all stakeholders in the programming process, including the regions, sectors and social partners. The minimum form of partnership is that of consultation, i.e., asking stakeholders for their opinion about the programming document, although consultation alone is not very likely to yield real ownership of the document.

It is a remarkable feature of the programming process in some EU candidate countries that this process has triggered a wider, and ongoing, debate on strategic issues and the future development of the country. Although this is a particular constraint at this stage, the next generation of programming documents will benefit from an emerging partnership culture. Ownership of the programming process seems to be of particular importance in the new member states.

The involvement of politicians from the very beginning of the programming process is also indispensable. They have to give the programming process political priority and status, and they have to support the allocation of resources, both financial and human, to ensure smooth functioning of the process. It is extremely important that a National Development Programme prepared as a part of the EU programming process becomes a document that is not considered to be a document prepared simply for “EU purposes” but a truly national programme, including nationally-funded measures.

The issue of developing reliable indicators for programming remains an important problem in the old member states, not to mention the new ones. In these countries there is often simply no data that could be used for setting reliable indicators for targeting the objectives in quantitative terms. The targets are therefore often formulated in qualitative terms.

In order to be successful in the programming process, the country needs specific skills. One group of skills is analytic in nature – it prepares SWOT analyses, socio-economic analyses, development strategies, indicators, etc. – while the other one is process-related and should be

familiar with the programming process as such. In addition to skills, programming requires carefully designed tools for project implementation. At the beginning, a clear assignment of responsibilities should be made. Each participant in the programming processes should have a clear mandate from the entity it represents.

Phase no. 3 – implementation; The key issues in this area involve the establishment of bodies – implementation agencies – that are responsible for implementation of the programmes. The administrative structure of the country involved is very significant in deciding how to implement the Structural Fund programmes. In some countries, a centralised model has been applied which concentrates as many measures as possible into a limited number of key agencies. It has advantages in terms of administrative costs, but its main disadvantage is that in this model the implementing agencies are often far away from the specific context of the individual measures. In other countries, more dispersed approach has been used.

One problem that has been experienced in many EU-candidate countries has been a lack of clear definition of the delegation of tasks and the reporting lines between the MAs and the implementing agencies. Another key problem faced by these agencies is related to procurement processes. The experience of some countries indicates that procurement presents a particularly high risk for these institutions. The problem has to be addressed by establishing appropriate structures and procedures which will give an assurance regarding compliance with the applicable legislation and rules.

Implementation bodies are commonly in charge of defining the context of measures and of developing project pipelines. They are also responsible for tasks ranging from evaluation, selection, and monitoring of EU sponsored projects. The most important tools of implementing bodies are their pipelines of projects. The way project pipelines are organised depends largely on the type of projects. For infrastructure and environmental projects, which involve large investments, the project pipeline is typically top-down with the NDP as an umbrella document supported by national strategies for individual infrastructure sub-sectors. For these projects, the pipeline is in fact prepared at the time when strategy documents are being prepared. For smaller projects and programmes, however, the project pipeline is generated more on a bottom-up basis, through tenders where publicity and promotion actions are crucial.

Staff of these agencies has to be equipped with other tools for effective assessment and prioritisation of project applications. Very often, some guidelines for the selection of projects are already given in the programming documents, but they have to be complemented with tools to carry out economic and financial cost-benefit analyses, and to measure environmental impact. Analysing projects is a time consuming task that requires experienced staff. Experience shows that it is not the funding level, but the number of projects that is decisive in determining the staffing requirement, as every project needs to be processed according to a similar format, irrespective of its size.

In order to process submitted project proposals effectively, clear, simple and easy to understand application forms should be designed. Experience shows that in many new Member states, unclear tendering procedures accompanied by badly designed application forms are important reasons for delays in implementing EU supported projects and programmes.

Phase no. 4 – monitoring and evaluation; This phase includes all the structures, human resources and tools that are required for the financial and physical monitoring of programmes. This phase of the cycle typically deals with (i) the organisational structure, mainly the MCs; (ii) the financial and physical reporting requirements from project beneficiaries; and (iii) the system of evaluation.

Monitoring is typically composed of two groups of tools. The first group provides a detailed reporting system for final beneficiaries. The second group of monitoring tools includes IT-based monitoring information systems. They may be based either on a central model to be imposed from above (top-down approach) or on a bottom-up model starting from the operational level.

As far as evaluations are concerned, experience shows that they are typically contracted out to independent private entities. Ex-ante, medium-term and ex-post evaluations are being carried out based on terms of reference prepared by MCs that set out the evaluation method to be used. The use of a standardised approach in evaluations is important in order to be able to make comparisons and to judge the overall impact of EU funded interventions.

Phase no. 5 – financial management and control; In all old and new member states the importance of financial management and control has increased significantly over recent years. The establishment of separate PAs is one of the manifestations of this development. The functioning of PAs across the Member states is very similar and typically includes the following tasks: (i) managing the payment of the Funds; (ii) submitting certified payment applications to the Commission; (iii) ensuring that final beneficiaries receive EU funds quickly; and (iv) making available detailed records of payments. Increasing requirements in this field have resulted in a sharp rise in the demand for staff with accounting and auditing skills.

There have been three key issues for the EU candidate countries in the area of financial management and control. *Firstly*, timely designation of the PAs is extremely important, as there is a lot of work to be done prior to the smooth implementation of the system. *Secondly*, provision of adequate expertise – in quantitative and qualitative terms – to carry out sound financial management and control. *Thirdly*, the introduction of systems, procedures and other tools required for efficient financial management and control. Experience shows that, although these issues have typically been correctly envisaged, many countries have faced delays and deficiencies in implementation. A key challenge for the accession countries has therefore been to ensure that the systems required for financial management and control are implemented in a correct and timely manner.

5. Absorption capacity in practice: case studies of Slovenia and Macedonia

5.1. Slovenia²⁷

Period before accession to the EU (1992 – 2004)

Slovenia became a recipient of the EU technical assistance in 1992. The most important instrument through which the assistance has been channelled was the PHARE programme, which could be divided into 3 periods:

1992 – 1995: transition period; In this period, first experience on a smaller scale has been gained in managing joined programmes with the EU.

1996 – 1999: pre-accession period; During this period Slovenia has successfully implemented the necessary preparation for adopting the responsibilities of the future membership in the EU (adoption of the *acquis communautaire*), participated in the development of inter-European linkages and used assistance resources for economic and social reforms. In the 1992 – 1999 period Slovenia was allocated 290 million € within the PHARE programme and 50 million € in bilateral help.

2000 – 2004: accession period; In the framework of the Agenda 2000, the financial assistance was increased to 3 billion € for all candidate countries. PHARE programme was re-oriented, while two additional pre-accession instruments were introduced: ISPA and SAPARD, which were intended to contribute to the preparation of Slovenia for an efficient use of resources from the Structural and Cohesion Funds. The overall allocation to Slovenia in the period after the year 2000 has been between 42 and 52 million € per year, which has been divided as follows (yearly allocations, prices 1999): 25 million € from the PHARE programme, including EUR 7 million for the cross-border co-operation with Italy, Austria and Hungary, 10-21 million € from ISPA and 6.4 million € from SAPARD.

In the 2000 – 2004 period, the implementation was in principle founded on one coordinator (Gov. Office for European Affairs), who agreed on a project-by-project basis what and how would be financed with the ministries and the Ministry of Finance on the other hand, who was responsible for sound financial management and payment applications to Brussels. Overall, Slovenia has been successful in getting the funds as the average absorption rate was around 95 per cent of the available resources. Apart from financial inflows numbers of other valuable experiences have been gained:

- For some programmes a multi-annual programming approach was used, which improved the understanding and know-how on the process.
- The new working methods required (and tested) new, more flexible organisational methods in the public administration, especially promoting mutual cooperation among departments.

²⁷ This sub-chapter has been prepared by Mr. Peter Wostner, Deputy Director at Government Office of Republic of Slovenia for Local Self-Government and Regional Policy, the managing authority for Structural Funds, Cohesion Fund and European Territorial Cooperation objective programmes.

That being said however a number of weaknesses have revealed as well:

- Problems in project preparation and very demanding documentation requirements by the European Commission (and national legislation).
- Due to complex implementation systems it became clear that division of responsibilities and tasks is of paramount importance, but extremely challenging to ensure at the same time.
- Staffing problems, not just because of limited vacancies available in the public sector, but also because of the time needed to train people as well as their fluctuation.

Finally, it should be born in mind that both on the level of EU as well as in Slovenia, this period was considered as a kind of testing period, where greater emphasis was given to using the available funds, rather than on the impacts; although the focus on impacts could be extremely valuable if taken on board as quickly as possible since it would make latter stages of implementation process easier as well.

Period after accession to the EU (2004 – 2006)

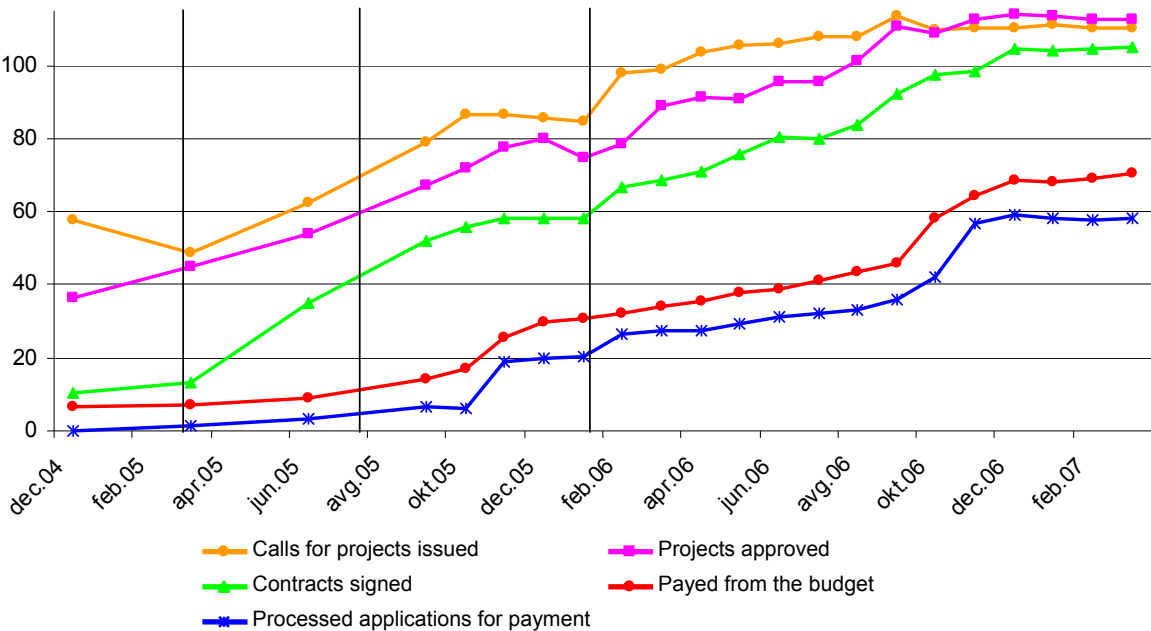
In May 2004, with around 12 years of “experience”, Slovenia has become a full member of the EU and thus gained access to cohesion policy “proper”. It quite quickly became clear that the already acquired experience is only of limited use. This is because every EU instrument has its own rules that need to be complied with and also because candidate countries tend to have less manoeuvring space than full Members, i.e. the European Commission tends to be more prescriptive in the candidate countries. Sometimes the combination of both factors has the consequence that in the latter stages, due to more flexible regulatory environment but established practices in the administration, management practices stay more restrictive and complicated than they otherwise could. Of course, this is not to say that the experience gain is not helpful - to the contrary, it represents a necessary input, however, in the transition period one needs to take note of the above mentioned effect.

For the 2004-2006 period Slovenia has negotiated 458 million € of which 237,5 million € for Structural Funds, 190,6 million € for Cohesion Fund and 30,1 million € for the two Community Initiatives, Interreg and Equal. The most interesting and relevant for the 2007-2013 period was the experience in using the Structural Funds, because of the now prevailing decentralized programming approach. The legal basis for the use of the funds was the Single Programming Document with 31 per cent going for human resources development, 35 per cent going for productive investment, 19 per cent going for basic infrastructure and 11 per cent going for agriculture.

The management and implementation system was initially structured on a two-level coordination system with one managing authority, which however did not have direct communication with the ministries - they were publishing calls for projects. Instead three intermediate bodies were introduced that coordinated the implementation for each fund (ERDF, ESF, EAFSG and FIFG), which, as will be presented later, posed serious problems.

This can be nicely illustrated in the following graph, which has a few valuable messages.

Graph 5.1.: Key absorption features for Slovenia in the period 2004 - 2006



Source: Data from Government Office of Republic of Slovenia for Local Self-Government and Regional Policy

Firstly, it clearly shows that cohesion policy is not just about spending the money but that number of steps needs to be taken in order to get refunds from the EU: calls for projects need to be issued, on this basis actual projects, which comply with all the requirements can have their contracts signed, then, after the implementation on the ground, come payments from the national budget²⁸ and only then reimbursements from the EU budget, provided, of course, that all the rules and procedures have been fully complied with in all previous steps. As you can see, there is significant delay from one phase to the other. Secondly, you will notice that there has been noticeable inflow of EU funds only by the end of 2005, i.e. one year and a half after the start of implementation. This was partly because of over-complex implementation system, however, this is only small part of the explanation as other new member states had the same experience: by the end of 2005 they have managed to pay out only 11 per cent of the available resources to the beneficiaries and get far less from the European Commission.

Lessons learned

Keep it simple and build on existing know-how; The cohesion policy can be set-up as a completely separate implementation system from the national policies, this however, was not a chosen strategy in any of the new member states. Slovenia as well as other countries integrated the cohesion policy requirements into the existing public administration system. This is advantageous to the extent that one can make best use of the existing knowledge (especially in the ministries and specialised agencies), which is of immense importance,

²⁸ The financial flow presented can also be organised in other ways, here, of course, we present the Slovene modality.

however, can in such a system it can be problematic to ensure common rules and practices. Most important is to keep the system and relationships simple and straightforward. On the level of general relationships among institutions this tends not to be too hard to ensure, however, the actual efficiency of the system also strongly depends on the more detailed forms and practices of doing business. On this level the importance of “common sense” cannot be overestimated.

Importance of clear division of responsibilities and tasks, which should be codified; Division of tasks, job descriptions etc. are the most wanted proof of administrative absorption capacity by the European Commission. This is clearly justified, as newly established relationships among institutions as well as internally is immensely vulnerable and sensitive to fluctuation of staff. It is not uncommon that entire systems are dependent on the knowledge of only a handful of trained staff. Division of responsibilities and their codification should therefore be considered as one of the priorities. Unfortunately this is significantly easier said than done, because it is extremely hard to really understand upfront the tasks and relationships, what they really mean, which also makes decision-making on “who does what” very hard.

Coordinated and centralized approach has particular merit when entering into cohesion policy; It is for the reason mentioned above that the centralized approach, while entering cohesion policy, makes a lot of sense. The centralized approach does not mean that one institution takes over the whole implementation process, but rather that one institution is held responsible to prepare and specify all the rules of engagement and also has the authority to oversee the activities of the intermediate bodies (usually the ministries). However, in order to do this task successfully, such institution needs to have very clear and strong political backing, because otherwise it is impossible to enforce new rules and procedures. Namely, the coordinated approach can often clash with the established relationships among the national institutions, and in such cases cohesion policy needs to be given clear priority. In the initial stage Slovenia simply introduced too many coordinating institutions, because too much power in one institution was at the time politically unacceptable.

Do not take programming just as a means to get the money but turn it to your advantage; OPs thus represent the basis for allocating available resources to particular activities. The importance of OPs is becoming increasingly strategic, whereby less attention is given to identification of particular projects and activities. Instead, focus is given to the rationale, strategy, objectives and their quantification, which also makes good basis for strengthened monitoring and evaluation. The preparation and negotiation of the OPs is a rather demanding task, which can last more than two years. In the process it is important to realise that the quality of programming phase will determine not just the impact of the spent monies, but will also make the implementation easier, especially in regards to reporting and evaluation. Furthermore, the programming exercise can have valuable spill-over effect for the national development policies, e.g. rationale and specification of policies can improve, the value-added of partnership, etc.

Quality of more detailed implementing provisions (e.g. calls for projects) is decisive; While OPs are immensely important it still needs to be recognised that they represent the necessary but not the sufficient condition. Even though the general objective of certain calls for projects can be fully justified and needed, one small requirement can prevent or at least reduce either the appeal of the call for the applicants or reduce the positive effects of the co-financed projects. The quality of implementing provisions is to a large extent dependent of the

professionalism and experience of the responsible institutions, but is also clearly a “learning-by-doing” exercise.

Preparation of projects takes a lot of time; In planning the implementation of the OP however, it is also important to make the preparatory work for the projects on time. This is especially relevant for the investment projects and especially for larger investment projects, which require extensive set of permits, plans as well as comprehensive cost-benefit analyses, environmental impact assessments, etc. Preparatory phase is not only time-consuming but can also be rather costly, so taking both this dimensions into account is of utmost importance. Slovenia and other member states had noticeable problems in this regard since, as it often happens, delays in decision-making simply feed through to other phases.

Financial management, if not properly combined into the national system, can become a major obstacle for efficient implementation; This is particularly relevant in those implementation systems that integrate the cohesion policy in the regular national administrative systems. The EU rules have specific requirements which, if coupled by a rather bureaucratic existing administrative system, can lead to very inefficient procedures.

Make sure you take note of the costs (not just monetary) for the applicants; The inefficient procedures do not only make the public administrative system less efficient and costly, but can also increase the costs of participating in cohesion policy for (potential) applicants / project holders. This can be due to delays in all phases (from publishing the calls for projects to processing payment applications), which can prevent normal progress of the project and also raises their costs due to liquidity problems, necessity to prolong contracts etc.

Conclusion

Slovene experience shows that in spite of long preparatory period and reasonable decisions taken on the implementation systems, there were still significant difficulties encountered in the beginning of the 2004-2006 period. Even though Slovenia in terms of absorption outperformed other new Member states, it still had been and still is faced with significant problems, which however are, by now, being solved without major perturbations but are instead becoming part of “business-as-usual problem-solving”. This illustrates that preparatory phase is of immense importance for preparing better starting position of the Member states, especially if political level attaches enough priority and importance to this policy on time, however, that at the same time, there will always be extensive learning period for the new entrants.

5.2. Macedonia

General introduction

The Republic of Macedonia has contractual relations with the EC since 1996²⁹ when it signed an agreement to be eligible for assistance from the EC PHARE programme. In 1997 it signed a Cooperation Agreement, in force until 2004, as well as Textile Agreements which were in force from 1998 till 2003. Following the conclusion of the negotiations at the Zagreb Summit

²⁹ Between its independence declared in 1991 and 1996, Macedonia was under unilateral and multilateral blockade and was out of the normal process of European Integration which has create long-lasting negative effects on Macedonian political and economic reforms

of November 2000, a Stabilisation and Association Agreement (SAA) was signed in Luxembourg in April 2001 (as first in the Region) and entered into force in April 2004.

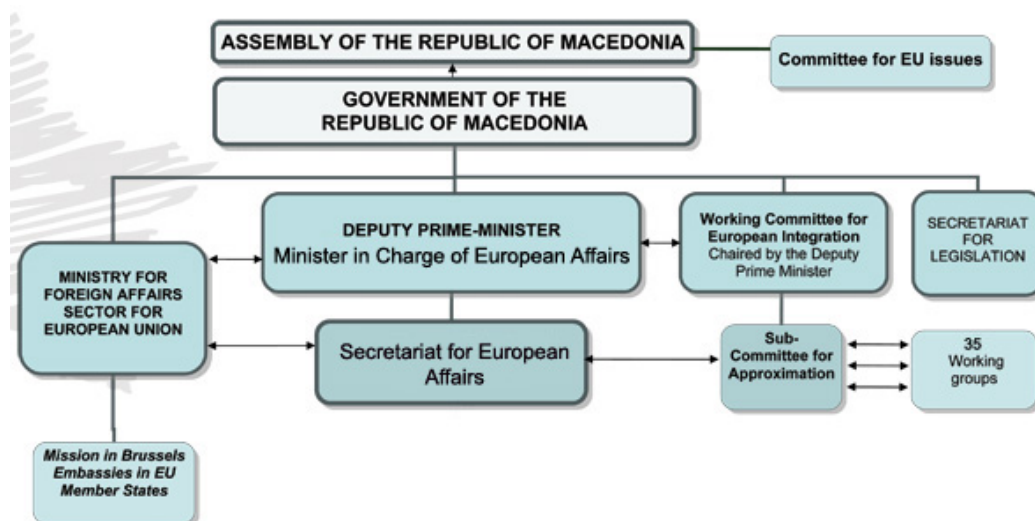
On 22 March 2004, in Dublin, Republic of Ireland, the Republic of Macedonia made a huge step forward and submitted the application for EU membership. Six months later, the Republic of Macedonia started the procedure of answering the Questionnaire, a tool of the European Commission that scans thoroughly the performances of the applicant country for membership in the European Union. By 31 January 2005, in less than 4 months, the Macedonian institutions have prepared the answers, realistically presenting the situation, and also the plans for advancement in each of the particular sectors in society. After reviewing the answers, the European Commission prepared an opinion (avis) which was recommending granting status of candidate country for membership in the EU.

The European Council on 17 of December decided to grant Republic of Macedonia candidate status for membership of EU. The Heads of States and Governments of EU Member states thus recognized the progress that Macedonia has made in meeting the Copenhagen criteria.

As part of the activities for EU approximation, on 6 September 2004 the Government of the Republic of Macedonia adopted the National Strategy for European Integration³⁰. It is especially important that this Strategy was supported also by the Assembly of Republic of Macedonia through the Commission for European Issues, thus confirming the general political consensus on European integration.

In December 1998, the Government set up the foundations of the management infrastructure for the European Integration process³¹. In the following period, in order to achieve greater effectiveness and efficiency, based on the foreign experiences, as well as greater commitments to EU, and taking into account the greater commitment to EU, made corrections and upgrading of the management and coordination system with the European integration process. So today, it has the following structure:

Graph 5.2: Management and coordination system for the EU integration process in the Republic of Macedonia



³⁰ National Strategy for Integration of the Republic of Macedonia in to the European Union was prepared and adopted by the Government and by the Parliament, as expression of consensus for the main strategic goal and sign of maturity of the whole Macedonian society

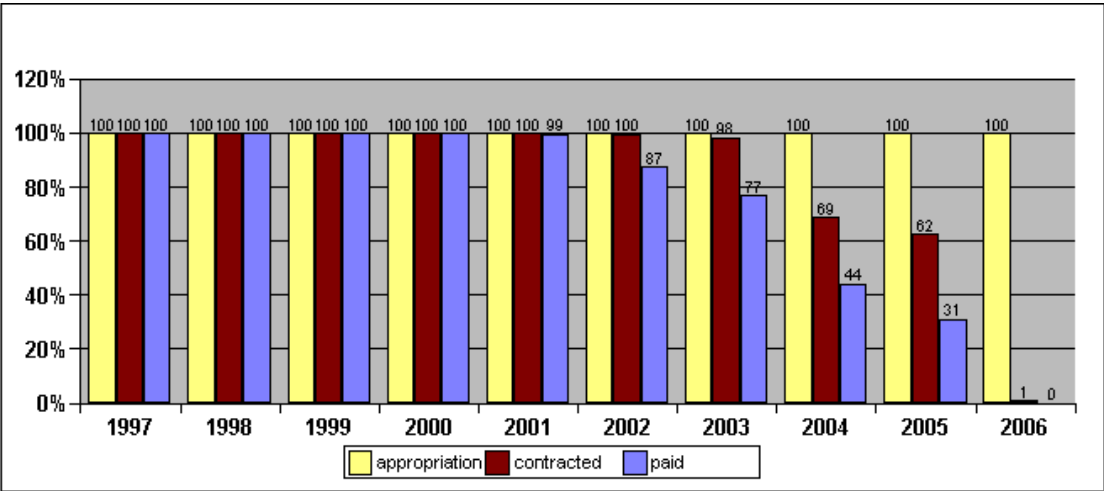
³¹ Web site of the Secretariat for European Affaires (www.sea.gov.mk)

The Government of Republic Macedonia has a history of mobilizing, implementing and benefiting from foreign assistance since its independence in 1991. In this period it has established the National System for Coordination of Foreign Assistance having the Deputy Prime Minister responsible for European Affairs as the National Aid Coordinator (and NIPAC at the same time), but also supporting structure in a form of Committee of Ministers for Coordination of Foreign Assistance, the Coordinative Technical Group and the Aid Coordination Sector within the Secretariat for European Affairs. Enhancing the possibilities of the established system and recognising the weaknesses that occur in the practice, the Government of Republic Macedonia, in cooperation with the international community, is putting serious and continuous efforts to improve and strengthen its role in the coordination of the foreign assistance.

Over the past decade the EU has delivered substantial support to the Republic of Macedonia through various programmes such as ECHO, Obnova, PHARE or the Emergency Response Programme. The EU also provided macro-financial assistance in the form of balance-of-payments support. In 2001, CARDS was launched to focus on political, institutional and economic transition. The total assistance of the EU to the country since 1992 amounts to more than 800 million €

The EU’s main institution for managing assistance in the region - the European Agency for Reconstruction (EAR)³² - has been efficient in delivering substantial amounts of assistance. Starting its operations in 2002, the EAR took over responsibility for the previous programmes and took forward the implementation of CARDS. The EU assistance portfolio managed by the AEAR in the country amounts to some 326 million € By the end of 2006 more than 80 per cent of this total had been contracted, and more than 70 per cent disbursed.

Graph 5.3: EU assistance portfolio managed by the EAR³³



³² European Agency for Reconstruction (EAR) was active in Macedonia since 2000 and its mandate expire at the end of 2008

³³ Although the EAR took over the responsibility from 2002, it was responsible for all the backlogs since 1997

Lessons learned from programming and implementing EU funds in the 2001 – 2006 period

After the crisis of 2001 EU assistance was directed mainly at rehabilitation and reconstruction of infrastructure as well as at police activities. The extensive support to the Police Reform has contributed significantly to the stabilisation process. A reform process was initiated, staff has been trained on both national and sub-national level, equipment and infrastructure has been provided. As the country's political and economic stability grew in recent years, EU financial assistance responded by widening its focus to include institution-building in the key areas of the EU *acquis communautaire*. EU assistance has been delivered within four priority areas identified in the Country Strategy Paper 2002-2006: (i) democracy and the rule of law, (ii) economic and social development, (iii) justice and home affairs, and (iv) environment and natural resources.

Building on the experience gained from programming and implementing EU funds in the country the following lessons have been learned:

- Implementation of assistance has required a level of flexibility commensurate with administration standards in the country. In particular, challenges were faced during the implementation of assistance as regards *absorption capacity*, where national institutions were endowed with inadequate staff, both in terms of quality and quantity. Thus, absorption capacity must be taken into account when programming assistance and targeted support to improving the capacities of public administrations is needed.
- Limited *budgetary resources* to maintain material investments or to cover regular operational expenses and insufficient working space to accommodate staff and equipment represent bottlenecks to efficient implementation of pre-accession assistance. Therefore, programming on the one hand has to consider scarce budgetary resources and on the other hand, the country has to allocate sufficient resources to complement EU assistance.
- The national government experienced difficulties in fulfilling their commitments regarding staffing, budget availability or completion of legal approximation prior to project deployment. *Increased ownership* of EU assistance to the country is essential for the effective programme implementation. It is necessary taking into account the country's own needs (e.g. as outlined in respective national documents). However, co-financing requirements shall also contribute to increased ownership. Political will and coherent decision-making on behalf of the beneficiary is essential in rectifying shortcomings and in ensuring sustainability in the implementation of pre-accession assistance. These issues have to be addressed during programme planning and implementation and have to be backed up by a regular dialogue between the relevant Commission services and the beneficiary.
- *Donor coordination* is of great importance to avoid any overlap of assistance
- Harmonisation of legal instruments across different sectors was not always an easy task. However, strong horizontal alignment (across sectors and stakeholders) could be achieved by *improving the coordination efforts among the ministries* and relevant departments.

The regional policy and coordination of structural instruments under IPA

As regards financial assistance, the new Instrument for Pre-Accession Assistance (IPA) started on 1 January 2007. The *2007-2009 Multi-Annual Indicative Planning Document*³⁴ (MIPD) for the Republic of Macedonia was adopted in May 2007.

³⁴ Commission Decision of 30/04/2007 on a Multi-annual Indicative Planning Document (MIPD) 2007-2009 for the Republic of Macedonia

CARDS assistance is implemented by the European Agency for Reconstruction and preparations are ongoing for the transfer of that responsibility to the Commission Delegation in Skopje. IPA assistance is implemented by the Delegation in Skopje. The EU aims to transfer the management of IPA Funds to the national authorities under the *Decentralized Implementation System (DIS)* once the national authorities develop the necessary capacity to assume this responsibility. Permanent challenge for the Macedonian Government is to develop sustainable and accountable administrations and institutions with appropriate capacity.

As for the Regional policy and coordination of structural instruments, during the last assessment of the European Commission ³⁵it has been concluded that Macedonia is progressing well at current extent. But, substantial efforts are still needed to establish the necessary institutional and administrative capacity at central and local levels to meet the regulatory and operational requirements stemming from cohesion policy.

As regards the legislative framework, the progress was made. *The Law on regional development* (framework legislation on regional policy) has been enacted. The law stipulates the objectives and structures of regional development policy. *The Law on public internal financial control* was adopted as well. Nevertheless, the legislative framework for financial management and control needs to be further amended and extended. Coherence between the national and Community legislation in the areas of *public procurement, competition, state aid and the environment* needs to be straightened. In this area, preparations are advancing.

Assessment says that there has been good progress with regard to the *institutional framework*. The Government has made relevant appointments with regard to the structural components of IPA including the Strategic Coordinator and operating structures. Significant progress was made in building capacity at the level of CFCD, National Fund and Ministry of Finance. Adequate administrative capacity needs to be built up, particularly in line ministries.

In the area of *administrative capacity*, progress was made in recruiting in those institutions that will be involved in the implementation of IPA. Training is ongoing except for line ministries where it is still needed. With regard to the local and regional level, substantial efforts are still needed to increase administrative capacity.

On programming, good progress was made. The Government adopted the *National development plan 2007-09* and relevant authorities drafted the *Strategic Coherence Framework*; which sets up the strategy for implementing the structural components of IPA. In addition, one Operational Programme on transport and environment has been prepared, as well as the *National Regional Development Strategy*.

With regard to *monitoring and evaluation*, appropriate systems and mechanisms for monitoring and evaluating the quality and impact of development programmes have yet to be developed. In the area of *financial management and control*, relevant authorities and procedures for the proper implementation of pre-accession financial assistance have started to be put in place, in particular at the level of CFCD and National Fund. Preparations in this area are at an early stage.

³⁵ European Commission Progress Report for Macedonia published on 6 November 2007

Institutional structure for IPA implementation

In order to meet the conditions for conferral of the management powers by the Commission, relating to IPA implementation and to fulfil its obligations, the Republic of Macedonia has designated the following bodies and authorities:

- National IPA Co-ordinator(NIPAC),
- Sectoral Co-ordinator for components III and IV,
- CBC Coordinator,
- Competent Accrediting Officer,
- National Authorising Officer,
- National Fund,
- Operating Structure by IPA component or programme,
- Audit Authority.

The NIPAC-National IPA Coordinator is appointed by the Government of the Republic of Macedonia and is under the responsibility of the *Deputy Prime Minister for European Integration*. The *Sectoral Co-ordinator* is appointed by the Government of the Republic of Macedonia to ensure coordination of the regional development Component and human resources development Component. This position is the responsibility of the *Deputy Prime Minister for Economic Affairs*. *Minister for Local Self-government* has been appointed as *CBC coordinator*, by the NIPAC.

The Minister of Finance has been appointed as the *Competent Accrediting Officer* for the Republic of Macedonia. He is and shall be responsible for issuing, monitoring and suspending or withdrawing the accreditation of the NAO and the National Fund. The Head of Public Debt Management Department of the MoF has been appointed as the *NAO-National Authorizing Officer* for the Republic of Macedonia. The NAO is responsible for the effective functioning and reporting on management and control systems under the IPA Regulation and for issuing, monitoring and suspending or withdrawing the accreditation of the operating structures.

The National Fund is a unit within the Treasury Department in the MoF. It acts as the central treasury and is responsible for financial management of assistance provided under the IPA Regulations, under the responsibility of the NAO. *The Audit Authority*, functionally independent from all actors in the management and control system and complying with internationally accepted audit standards shall be designated by Republic of Macedonia. The Government of Macedonia has decided the function of the Audit Authority to be performed by the State Audit Office.

Operating structures are established to support the management and implementation of assistance under the IPA Regulations. *The Central Finance and Contracting Department (CFCD)* under the supervision of the Ministry of Finance has been established for regulating the actions under the responsibilities of the Government that are deliverable under the first four components of the IPA. For *the Transitional Assistance and Institution Building and for Cross-Border Components* CFCD shall act as an Operating Structure.

For *the Regional Development Component* of IPA, for the beginning, until capacities of the line ministries are building up on a qualitative level, CFCD shall act as an Operating Structure with the possibility of delegating some functions to the SPO/Ministry. Within the Ministry of

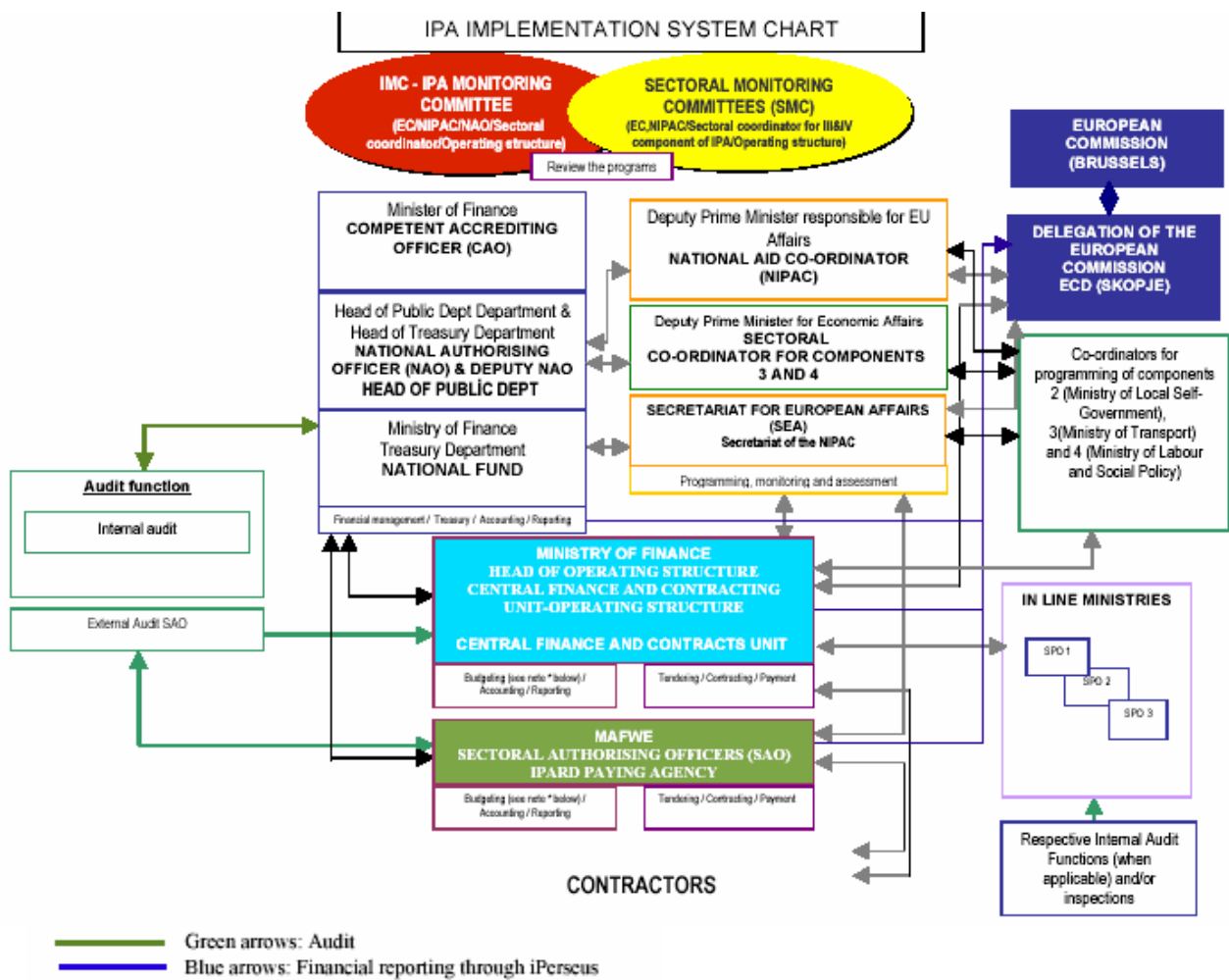
Transport and Communications and the Ministry of Environment and Physical planning, a Senior Programme Officers were officially appointed to ensure that programming and the technical aspects concerning the preparation and implementation of the programmes, as well as reporting to respective authorities are carried out in an effective and timely manner. Within the Ministry of Transport and Communications and the Ministry of Environment and Physical planning *Units for Implementation of IPA* were established in order to support the SPO's and the activities for programming and actual implementation of the projects under the RD Component.

For *the HRD-Human Resource Development Component* of IPA, for the beginning, until capacities of the line ministries are building up on a qualitative level, CFCD shall act as an Operating Structure with the possibility of delegating some functions to the SPO/Ministry. Within the Ministry of Labour and Social Policy and the Ministry of Education and Science, Senior Programme Officers were officially appointed to ensure that programming and the technical aspects concerning the preparation and implementation of the programmes, as well as reporting to respective authorities are carried out in an effective and timely manner.

For *the Rural Development Component*, pursuant to the Government Decision, the Ministry of Agriculture, Forestry and Water Economy (MAFWE) is responsible. For the purpose of implementing this Programme, MAFWE has established Department for Rural Development which is responsible to ensure revision and updating of this Programme. The Agency for Financial Support in Agriculture and Rural Development is established as an independent body of the state administration with a status of legal entity. The Agency shall perform activities within its authorities on the basis of the principles of legality, competency, professionalism, responsibility, efficiency and transparency.

The Republic of Macedonia shall set up an *IPA monitoring committee and Sectoral Monitoring Committees* in order to ensure coherence and coordination in the implementation of the programmes and operations implemented under the different IPA Components, as well as for any cross-Component corrective measures needed to ensure the achievement of the global objectives of the assistance provided, and to enhance its overall efficiency

Graph 5.4: IPA implementation system chart for Macedonia³⁶



³⁶ Current structure of IPA implementation system which is in process of accreditation

6. Administrative / institutional conditions to be created by Kosovo for its effective absorption of EU cohesion funds

Kosovo is still in rather early stage of its accession to the EU. With a status of a potential candidate for accession to the EU, Kosovo has a rather limited access to the IPA funds. It is hoped that in a not too distant future Kosovo will graduate from the status of a potential into the status of an official EU candidate country. It is realistically to expect that this change of a formal EU accession status will be accompanied with an increased annual volume of EU budget funds available for Kosovo's cohesion policy. It is within this framework that absorption of EU cohesion funds deserves particular attention of the Kosovo's authorities.

The discussion about the conditions to be created by Kosovo for effective absorption of EU funds aimed at economic and social cohesion or capacity of Kosovo will be strongly focused on the discussion about the administrative / institutional conditions to be created for effective absorption of EU cohesion funds. The reason simply is that, based on the experience of the 12 new member states that joined the EU in 2004 and 2007, administrative / institutional absorption capacity has by and large represented a major problem. This does not mean that the other two aspects of the absorption capacity presented in *sub-chapter 4.1. – Macroeconomic and financial* – may be considered as absolutely non problematic³⁷. Nevertheless, problems associated with these two segments of the absorption capacity have proven to be much less problematic in the pre-accession period than problems associated with processes of establishing appropriate administrative / institutional structure for effective use of EU cohesion funds.

6.1. Future Decentralized Implementation System (DIS) in Kosovo

General introduction

In all the countries that have the objective of becoming an EU candidate country, it is important to prepare the public administration for the tasks of managing EU funded programmes. Kosovo is in a process of initiating the relevant preparations in drafting a roadmap with recommendations as a guide to establish the IPA decentralised management structure.

³⁷ *Macroeconomic absorption capacity*; It has been mentioned already that EU candidate countries have never in past been in a situation that they would receive from the EU budget financial resources for cohesion purposes equivalent to more than 4 per cent of their respective GDP; for the multi-annual financial perspective 2007 – 2013 this ceiling has been reduced to 3.6 per cent of GDP. If Kosovo will have access to some 60 – 70 million € of EU pre-accession funds in the years to come that would be equivalent to around 3 per cent of its GDP (According to the document titled Macro-economic Framework for Kosovo 2007 – 2013, Pristina, June 2006, Kosovo's GDP is expected to be at an annual level between 2.2 and 2.3 billion € in the period 2007 – 2009, and should grow to some 2.8 billion € in 2013). As a large proportion of these funds will be allocated for institutional building purposes, the volume of funds for cohesion purposes will be significantly below the 3.6 per cent of GDP ceiling. Based on this fact, it could be concluded that macroeconomic absorption capacity is not expected to a limitation for Kosovo's effective absorption of the funds for cohesion purposes.

Financial absorption capacity; The standard national co-financing rate for pre-accession cohesion funds has been 25 per cent. If we forecast that Kosovo will be entitled to receive total pre-accession assistance equivalent to some 60 – 70 million €, then the total amount of required national co-financing can be roughly estimated at a level equivalent to around 1 per cent of GDP. A detailed analysis of Kosovo's public expenditure structure would be needed in order to make a qualified assessment whether national co-financing could be expected to represent a significant obstacle for effective absorption of EU funds or not

Instrument for Pre-Accession is a new financial tool directed to assist the countries that are actively preparing for EU accession to develop their administration, to align the legal framework closer to the EU *acquis* and to prepare for the management of future financial instruments of the EU member states. The five components of IPA are: Transition Assistance and Institution Building, Cross-border Cooperation, Regional Development, Human Resource Development and Rural Development.

The first two components are already available for Kosovo but the components III, IV and V shall be made available only after Kosovo becomes an EU candidate country in the future. In addition to that, a candidate country can start benefiting from the other three components only after its structures and management systems are set up in accordance with the minimum requirements for Decentralised management system (DIS). Decentralised implementation system means that the responsibility of implementing the IPA programmes would be transferred from the Commission (EAR / EC office) to the Kosovo Government institutions.

Under the decentralised management the functions of (i) *implementation of projects*, (ii) *organising of public procurement*, (iii) *managing the contracts*, and (iv) *making payments to the beneficiaries or contractors* would no longer be carried out by the European Commission services (EAR / EC office in Kosovo) but by the national authorities.

The Commission will make the decision for decentralisation only after a careful assessment and in the case the minimum requirements as established in the IPA regulations are met in the beneficiary country. In order to ensure that the requirements are met, the beneficiary country must ensure in general the following:

- Establishment of clear systems and designation of institutions responsible for programming and monitoring, for financial management, for programme implementation and for auditing of IPA programmes.
- Nomination of high-level officials responsible for national programming and for the implementation of programmes.
- Relevant legal framework is in place to ensure proper functioning of the system.
- Separation of functions at least between programming of funds and implementation; between procurement and payments; between implementation and audit.
- Recruitment of an adequate number of staff relevant to administering EU funds, provision of relevant training and the availability of detailed management tools (guidelines, procedures' manuals etc).

The rules governing the implementation of IPA programmes are set in the following legal acts:

- *Council Regulation (EC) No 1085/2006* of establishing an Instrument for Pre-Accession Assistance (the IPA Framework Regulation), which establishes very general rules for the administrative setup for IPA, and
- *Commission Regulation for implementing the Council Regulation No 1085/2006 (the Implementing Regulation)*, which is a very detailed and practical set of rules particularly in the context of administrative arrangements.

Preparing for DIS is without question a demanding and time-consuming exercise. Although Kosovo will be in the first instance only recipient of the components I and II under IPA, it should nevertheless prepare its future DIS structure for the management of the components

III, IV and V. Based on the experience of other countries, the process of preparing for DIS would take 2 – 3 years minimum.

Structures that need to be set up and designate

According to the Implementing Regulation establishes the list of different bodies and authorities to be designated:

- a national IPA co-ordinator (NIPAC),
- a strategic co-ordinator for the regional development component and the human resources development component,
- a competent accrediting officer (CAO),
- a national authorising officer (NAO),
- a national fund (NF),
- an operating structure by IPA component or programme (CFCD and SPOs),
- an audit authority (AA).

Further on the beneficiary country needs ensure the appropriate *separation of functions*³⁸. This has to be done at least between the following broader functions: (i) programming and technical implementation, (ii) procurement and payments, and (iii) audit and all other management lines.

General situation in the Kosovo government institutions³⁹

The civil service in Kosovo is very young and typically for a small society remarkably slim. The number of civil service in the central administration is insufficient. At the same time the administration is under pressure of several parallel processes, including Kosovo status. Therefore all new developments (including setting up the DIS structures) need to be analysed through as carefully as possible in order to avoid unnecessary burden to the administration.

The ministries in Kosovo are managed by the political ministers and deputy ministers (in addition there are two deputy prime ministers for priority fields, such as EU integration). The highest civil servant is the Permanent secretary for a ministry who is the administrative head of the ministry.

As already mentioned, EU integration is commonly recognised as a priority area of development. This has enabled the *Agency for European Integration* to create close working relations with all the ministries, at least in the area of programming for IPA and in starting with early preparations for decentralised IPA management. This will most likely help to keep also the DIS preparations among the top priorities of institutional development in Kosovo.

The general knowledge about IPA and DIS has improved since spring 2007. So far the Kosovo authorities have participated in the preparations of the *Multi-Annual Indicative Planning Document (MIPD)*, which is the basis for the programming and implementation of the Instrument for Pre-Accession Assistance (IPA) Assistance 2007-2009. Also the first annual programme, IPA 2007, is ready. The programming of IPA 2008 programme is

³⁸ European Commission Document, EDIS Lessons Learned-Main Issues,

³⁹ The PAR Strategy and the Action Plan were approved by the Kosovo Government on 21 March 2007.

underway. The ministries that have participated in these processes have basic understanding of the general concept of IPA.

The technical implementation of the CARDS programmes has been carried out by the *European Agency for Reconstruction (EAR)* that has its latest mandate until the end of 2008. By that time the *European Commission office (ECO)* in Kosovo will be established and also the responsibility over the management of the ongoing CARDS programmes and the fresh IPA programmes will be handed over to the staff of the ECO.

The Agency for European Integration (AEI) is well anchored, relatively strong, ambitious and proactive organisation with a staff capacity foreseen in the systematisation act around 35 together with the legal and translation services being set up (currently around 21 officials are recruited). The IPA section in AEI has a staff of 3, which is not sufficient at all. The AEI has began its first step towards playing a role as a National IPA Coordinator (NIPAC) in the first coordination process of gathering project log frames together with the EAR for the IPA 2007 programming process. The same is done for IPA 2008 but in a more systematic way with a bit of stronger ownership. But still the EAR is playing a vital role in the process and the AEI does not lead the most important aspect of programming, i.e. setting the priorities for new IPA projects.

The set-up is good in order to develop a strong programming capacity in the near future. The plans to do systematic donor coordination and to gain stronger role in the process of programming of IPA funds both create the basis for the future NIPAC office.

The AEI has also ambitious in leading the DIS agenda. However, as the focus in the minimum requirements for DIS will be placed heavily to the Ministry of Finance, it is advisable that at some point of time the leading role of the DIS preparations should gradually be shifted from the Agency to the Ministry of Finance.

The Ministry of Economy and Finance in Kosovo has a relatively understandable portfolio. The Ministry of Economy and Finance is responsible for the coordination and financial management of the Kosovo Budget. Basic functions of the Ministry include:

- Development and implementation of fiscal policies and administrative systems.
- Economic analyses and macroeconomic projections;
- Budgetary planning;
- Development and implementation of a Central Tax Administration, and
- Development and implementation of a Central Treasury and accounting system.

In this context the extra workload coming with DIS is significant. The *understanding that the M of EF* could lead the future DIS developments is still modest. Before the designation of the key authorities (the national fund, the audit authority, and the central implementing agency) it is important to ensure that there is a strong driving commitment from the top management of the Ministry of Finance.

It is likely that both the *National Authorising Officer (NAO)* and the national fund will be set up within or close to the Treasury. The quantitative capacities in the Treasury should be increased in order to incorporate also the functions of the national fund (as these functions are foreseen in the IPA regulations). The actual readiness to start preparing the new structures needs probably formal commitments taken at the level of the Government.

There are no final plans for the central implementing agency (can be referred also as the *Central Financing and Contracting Department-CFCD*). There is nevertheless a strong opinion that it should be within the Ministry of Finance. In the beginning it can be that the group of people who would prepare the CFCD in the Ministry of Economy and Finance would start directly under the minister. This can be a reasonable solution for the time being, as long as the *Public Authorizing Officer* for the first (and possibly also for the second) IPA component is nominated in the near future. The permanent structures can then be established on the basis of this group of professionals either in the Ministry of Economy and Finance or as a separate administrative body under the ministry.

The Audit Authority functions would most logically be placed within the Ministry of Economy and Finance. However it will be difficult to decide, where to place *the Competent Accrediting Officer* as the administration is small and the requirements regarding segregation of duties are planned in the Commission regulation to be even tougher than they were in the past. The discussions regarding the system of internal audit (and in this context the role of the Ministry of Economy and Finance) should go on within the process of preparing for the policy of *Public internal financial control (PIFC)*⁴⁰.

6.2 Roadmap for the DIS preparations⁴¹

In order to outline a reasonable Roadmap for the DIS preparations in Kosovo, the following four stages of DIS preparations have been sketched in order to systematize the process ahead. This four stage model follows the approach elaborated by the Commission for the EDIS preparations for PHARE and ISPA (for the previous round of EU candidate countries). *The only major difference is that the first stage cannot and should not be called in Kosovo “gap assessment”, as there is no existing system where the gaps could be identified.*

Under each of the *four stages*, the key issues to be dealt with have been listed. For the first phase issues and some of the most important for the further phases, some comments and practical recommendations were added.

Preliminary work to set up the “DIS project” (Stage 1):

- *Preparation and adoption of the DIS strategy paper at the level of the Government;* The strategy should include the process concept, an indicative work-plan, division of tasks for the future DIS system and the first budget estimates for the years 2009 and 2010). In this document the division of tasks and responsibilities between different institutions and different ministries should be described in as much detail as possible. Also the staffing needs assessments require some information on the division of functions. It is important that the DIS strategy is elaborated in cooperation with the AEI, the MoF and other ministries and without further donor assistance. It is critical that the preparations for the DIS strategy are used for learning and raising the

⁴⁰ SIGMA (Support for improvement in governance and management) Kosovo public internal financial control (PIFC) assessment June 2007

⁴¹ European Commission Document, Road map to DIS for IPA,

capacities of the AEI and the MoF, therefore too strong outside assistance would not bring in any additional benefits.

- *Nomination of a “DIS project manager”*; In the context of the DIS strategy preparations, it is important to nominate a working level “DIS project manager”, a person who has been designated full time for the DIS preparations, who has the time and the skills to coordinate several experts and many activities, and who also has the mandate (at least unofficial recognition) to coordinate the actions in various ministries. A higher level official responsible for the DIS preparations should also be nominated. In case the MoF is able to commit itself for DIS, it would be good for the longer process, if the “DIS champion” is nominated from the MoF. Until the MoF will take over the leading role for DIS, the AEI should continue with their current commitment to lead and monitor the process. All the following activities under stage 1 should be closely linked with the process of elaborating the DIS strategy.
- *Establishing the structures and nominating the key officials for the management of IPA*; Key officials (NIPAC, CAO, NAO, PAO) need to be nominated or at least certain unofficial and reliable consensus on these nominations needs to be found as soon as possible. This can be done also in the context of the DIS strategy paper. The systematic development of the relevant structures can be facilitated by nominating the persons responsible and enabling them the relevant financial resources (as a minimum it is required that one or two full-time officials are designated for DIS preparations in the earliest time possible).
- *Establishing coordination mechanisms for the DIS preparation and ensuring proper process management*; It is advised that the person in charge of the whole process should be a high-level civil servant (e.g. Permanent Secretary or other high level ranking official of the Ministry of Finance) and the person should be supported by an adequate full-time and in-house support (in the beginning at least one full-time official should be designated). It is important to have the responsibilities for preparations in the Ministry of Finance, as most likely also the core of the new work would be organised by the MoF. The Agency for European Integration should monitor (and participate in) the preparations as closely as possible in order to ensure progress. At the same time inter-ministerial coordination needs to start working regularly (an operational working group may be sufficient, as a higher level coordination bodies are already available for the wider agenda of the European Integration – e.g. Working Committee for European Integration and its Working Groups).
- *Raising the awareness and knowledge on IPA and the DIS requirements*; This should be done first of all in the initiative of the AEI and the Commission services (small seminars, DIS specific meetings, guidance notes, background documents and regulations – at least the model Framework Agreement translated and circulated to the key persons in the ministries etc).
- *First recruitments and staffing needs assessment for the coming years (together with recruitment plans)*; It is important to have at least some kind of staffing estimates known at a very early stage. This will be the basis for budget planning and for planning of training activities. However the first general staffing needs assessments cannot normally come earlier than the decision on general DIS structures. In principle

the first plans for staffing (2009 and 2010) can be incorporated into the DIS strategy in order to give the ministries some assurance of the priority of these recruitments.

- *Update of training plans;* The Kosovo authorities have started since late 2007 a training plan for IPA. This however is fairly general and concentrates its focus on programming and monitoring (the NIPAC area of coordination). Based on the new knowledge (e.g. the IPA Implementing Regulation) and the preliminary staffing needs the training plans can be updated. This would be a useful exercise to feed into the DIS strategy as well.
- *Establish good working relations with the EC office and the EU Commission, DG Enlargement;* The ECO will take over the work of EAR and is being set up by the end of 2008. It is crucial that the staff of the AEI and all the relevant ministries give support to the implementation of the IPA projects (this means doing the practical work of preparing the terms of references and technical specifications, also participating as tender evaluators). This would ensure also active cooperation and a good learning opportunity for the ministries. As for the DIS, it is likely that the ECO would not have strong capacities in the beginning. Therefore it is important that there are close working relations also with DG Enlargement.

Stage 1 would normally (with good political commitment) take 8-12 months to do with reasonable dialogue between all relevant stakeholders.

Preparations for DIS (Stage 2):

- *Recruitment or designation of first full time staff members to the National Fund and to the central implementing agency and gradually continuing recruiting more during this stage;*
- *Involvement of expert advice (TA) to the preparations of DIS, e.g. contracting the TA for DIS preparations;*
- *Elaboration of detailed division of tasks between different management lines, drafting of procedures for all the key functions;*
- *Preparations for the national legal system for the management of IPA;*
- *Training of staff already recruited (or potentially moving on IPA matters in the future);*
- *Further consultations and cooperation with DG Enlargement;*
- *Preparation of the terms of reference and tender for testing the compliance of the new structures prior to the accreditation decisions by the National Authorising Officer and the Competent Accrediting Officer;*
- *Planning additional support for the Kosovo authorities for the decentralised management of IPA;*

Stage 2 should take about 12-18 months (if well planned and if the first recruitments by the relevant units do take place in time)

Analysis for DIS compliance (Stage 3):

- *Completing the tendering and contracting of the audit firm for the compliance assessment;* The delay in compliance assessment would delay also the whole process, as also the accreditations by the NAO and the CAO are pending on the audit as well.
- *Compliance assessment (systems' analysis / audit);* According to the Implementing Regulation before the Commission will decide for decentralisation, the national authorities (the CAO for the national fund and the NAO for the other operating structures of the particular component or programme) need to decide on the accreditation of the implementing structures concerned. This accreditation can only be done relying on an independent and up to date system's audit.
- *Making adjustments to the system and completing the preparations for DIS;*
- *The NAO and the CAO take their decisions for accreditation;* This can only happen if the critical findings (if any) from the compliance assessment audit are accepted and the systems and procedures have been changed accordingly.
- *Submission of the request for DIS to DG Enlargement;* This can be done only after the NAO and the CAO have made positive decisions on accreditation. This can also be done only for one or some of the IPA components depending on their readiness.⁴² It is important to receive from the Commission detailed requirements for the DIS request package, as it will not be just a letter asking permission to start implementing in a more decentralised way. Together with the DIS request descriptions of the administration, organigrams, descriptions of audit trails etc are expected to be attached to this request.

Stage 3 could take up to 6 months time (in case there are no major problems with contracting of the audit firm and if the changes that need to be done after the audit findings do not take more than 1-2 months).

Assessment by the Commission (Stage 4):

- *EC verification activities and possible positive decision on moving towards DIS;*
- *Responding officially to the findings and recommendations of the Commission auditors and taking action according to the issues raised by the Commission;*
- *Possible shift to decentralisation (by programme or by pilot projects taking over the previous contracts from the EC delegation etc);*
- *Continuing with recruitment of staff to all DIS structures that have received positive decision by EC. See also the heading Broad staffing estimations for further background;*

Stage 4 takes at least 6 months (if the preparations have been done well – structures in place, a number of staff recruited and aware of their roles and tasks etc). It can take also up to 12 months even if the Kosovo authorities are fully committed.

⁴² Submission of the request for DIS regarding the IPA components III, IV and V depends also whether Kosovo has become an official EU candidate country by that time or may become that in the future.

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 - The Office of the Prime Minister of Kosovo
 - Assembly of Kosovo
 - United Nations Interim Administration Mission in Kosovo
 - OSCE Mission in Kosovo
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 - UNOSEK (United Nations Office of the Special Envoy for Kosovo)
 - The Government of Republic of Macedonia
 - Secretariat for European Affairs,

Annex 1

Outlines from the June 2007 SIGMA assessments and recommendations on other relevant sectors for introduction of the Decentralized Implementation System (DIS)⁴³

Kosovo public service and the administrative framework assessment

The PAR Strategy and the Action Plan were approved by the Kosovo Government on 21 March 2007. The PAR Strategy has set the following list of activities and priority actions:

- Development and approval of basic legislation in the area of public administration;
- Development of a unitary accounting system in line with international accounting standards to ensure the accurate recording of income and expenditure and to train personnel in using the system;
- Functional review of institutions and implementation of recommendations;
- Establishment of the Agency for Information Society;
- Development of the Strategy for Communicating with the Public, including implementation of the law for access to official documents and identification of government services provided on the Internet;
- Setting in place of mechanisms to monitor the implementation of legislation.

Kosovo seems to have clearly taken the route towards Europe, and the emerging government, which is a proper Kosovo Government, is making considerable efforts to harmonise existing legislation with European standards and to reorganise and operate its public institutions on the basis of common European values and approaches.

However, according to SIGMA recent Report on public services, the Kosovo civil service is politicised and lacks administrative capacity and professionalism. This is mainly due to the complex and difficult legal and institutional environment, low salaries, and the lack of capacity to implement legislation and to co-ordinate civil service management. Due to the previous, turnover in the civil service is high. Consequently, institutional and human capital is wasted and effective knowledge management is poor.

Recommendations:

- Concentrate efforts on implementing the PAR Strategy and Action Plan;
- Further review and harmonise the administrative legal framework in accordance with the prevailing legal culture so as to ensure coherence, promote transparency and legal certainty, and prevent corruption; review, simplify and rationalise the enormous

⁴³ The following four reports were prepared within this context:

- SIGMA (Support for improvement in governance and management) Kosovo public service and the administrative framework assessment, June 2007.
- SIGMA (Support for improvement in governance and management) Kosovo public procurement assessment, June 2007.
- SIGMA (Support for improvement in governance and management) Kosovo public internal financial control (PIFC) assessment June 2007.
- SIGMA (Support for improvement in governance and management) Kosovo external audit assessment, June 2007.

quantity of laws and by-laws regulating the public administration, which currently emanate from different entities and use different legal approaches;

- Ensure that the institutional set-up is adapted to a reviewed administrative legal framework so as to clarify administrative structures and improve administrative accountability, making it more sustainable by Kosovo's own resources and increasing accessibility to the citizen;
- Finalise the new draft civil service law, ensuring that it is in line with general standards and apt to promote a professional and impartial civil service, and that it properly balances the principle of merit and that of representativeness; replace the three-year contract duration with a system that provides conditions for stability, as stability is a precondition for professionalism;
- Establish civil service terms and conditions of employment that support the attraction and retention of skilled staff and promote the development of a professional civil service and institutional capacity-building; in particular, adopt and implement a new salary system;
- Develop a better understanding of what professionalism means and consequently promote stability in the civil service, including in managerial positions;
- Further develop the capacity of the training institution to co-ordinate all training activities and to develop and systematically deliver general in-service training as well as tailor-made training for individual institutions, so as to promote professional development and training at all hierarchical levels in the public administration, including at municipal level; the integration of training in the law implementation process should be systematic;
- Strengthen a single central capacity responsible for the policy proposal and management of the civil service, and endow it with sufficient legal powers to ensure homogeneous management standards across the administration;
- Ensure that fundamental principles related to the public administration system are set out in the future Constitution, creating a clear and solid basis for future development;
- Finally, give the main responsibilities for the governance system, to political institutions in Kosovo, limiting the role of international organisations to monitoring and support and concentrating on promoting the effectiveness of the governance system.

Kosovo public internal financial control (PIFC) assessment

The Policy Paper on Public Internal Financial Control (PIFC) was approved by the government in January 2005, (Decision 4/130) and amended on 1 March 2006. In the broad sense of the term, the internal control structure has been established. The basic legal framework is sound, with clear structures of accountability. To date many staff have been trained and a number of workshops have been held, both for staff dealing with financial management and control and for those dealing with internal audit.

However, according to SIGMA recent Report, it seems the notion of internal audit does not seem to be understood. As there is still a general confusion about the distinction between internal control and internal audit, and line managers' knowledge of accountability and its aims is lacking, it is difficult to implement PIFC.

The central harmonization unit for financial management and control (CHU/FMC) has recently been established, and the CHU for internal audit (CHU/IA) is partly ensured by the Internal Audit Department in the MFE. It seems urgent for the CHU/FMC to concentrate on

extending the training of staff working on financial management and control systems in budget organizations.

The functional independence of internal audit is not ensured.

Recommendations:

- Priority should be given to enhanced and increased understanding of the meaning of given responsibilities in the accountability chain,
- To further advance internal audit. It is crucial to strengthen the professional capacity in financial management and control in the Ministry of Finance and Economy, line ministries and municipalities so as to ensure the enhanced implementation of the new legal instruments on financial management and control. In particular:
- In addition, it is important to develop and establish organisational values and culture.
- The promulgation and implementation of the Internal Audit Law is crucial for the institutional establishment and strengthening of internal audit. Consideration could be given to reviewing the Internal Audit Law so as to ensure that in the long run it is compatible with internationally recognised internal audit standards.
- Further development of linked legislation is needed, such as updating of the internal audit manual and the Internal Audit Charter to align them with the Internal Audit Law.

Kosovo public procurement system assessment

As indicated by Sigma, the Public Procurement Law (PPL) 2003/17 has improved the correspondence with the *acquis* and appears to have been well communicated to contracting authorities. The independence of both the Public Procurement Regulatory Commission (PPRC) and the Public Procurement Agency (PPA) seems well established, and the resources, although still limited, are growing. The public procurement system in some respects meets EU requirements and other aspects of good procurement practice.

However, further changes in the PPL will be needed to make the law more flexible. Further substantial work will be required to upgrade administrative capacity and systems for monitoring and controlling procurement activities (including independent control and audit functions outside the procurement system itself). Continuing efforts to improve the efficiency of the public procurement system at the operational level are needed in order to ensure fair competition and professional handling of tenders and to encourage the development of competition in the domestic market.

Recommendations:

- Consider the introduction of the free use of the restricted procedure, especially for utilities;
- Place more emphasis on the use of the restricted procedure in future training in public procurement;
- Place more emphasis on the use of award criteria other than lowest price (“economically most advantageous offer”) in future training in public procurement;
- Consider the introduction of a specific utilities procurement regime based on EC Directive 2004/17.

Kosovo external audit assessment

According to SIGMA recent report the establishment of the Office of the Auditor General has gone through many challenges before being established. Perspectives set out in the Strategic Development Plan are promising. But, SIGMA experts highlight that as there are still a fairly large number of international advisors, it remains unclear whether Kosovar officials will take ownership of the reform agenda that has been developed.

An external audit function that meets INTOSAI auditing standards and related “good practice” approaches are being introduced. Basic functions are in place and the OAG has established a professional audit environment.

However, the challenge will be to apply the INTOSAI auditing standards, adapted to the Kosovo environment, through the audit manual and related guidelines. It will take a considerable amount of time and effort before a professional and Kosovarised supreme audit institution is fully established.

Recommendations:

- Attention should be paid to the phasing out of restrictions weighing on the freedom to report, to the further strengthening of the relationship with parliament, and in general to the way in which the future of the institution is organised.
- In particular, measures should be taken to ensure the adequate budget of the Office of the Auditor General.
- Further actions to raise awareness among the nearest stakeholders – i.e. parliament and the government – regarding the role and function of an audit institution would be useful.
- It is also important to focus on the borders between the “project” and the “day-to-day” operations of the OAG. A roadmap with a timetable should be drafted to identify specific “handover” milestones.
- In addition, it is important to develop and establish the organisational values and culture. Experience has shown that it takes at least ten years to establish a modern audit office, and it takes an average of four to seven years to properly train a professional auditor.

The development of the SAI in Kosovo should not be undertaken in isolation. Progress in the development of related areas of public internal financial control and notably internal audit should be monitored and co-ordinated.

Some options for the DIS structures in Kosovo *Discussion Note*⁴⁴

This Note discusses in some more details requirements and preconditions for introduction of the Decentralised Implementation System (DIS) which are necessary for successful preparation of Kosovo to manage Instrument for Pre-accession Assistance funds and Cohesion Policy Assistance.

There are several dilemmas (and options) which need to be further analysed and thoroughly discussed. Therefore, the structures, solutions and capacity needs recommended in this Note should be taken as preliminary (they are largely based on the desk work and experiences of the author) and should be further tested.

Basic elements of the DIS structure

The basic structures for DIS are in quite many details prescribed in the IPA regulations. Therefore the Kosovo authorities have certain constraints and particularly in a small administration there are not so many options between different units for various bodies foreseen in the regulations. The following recommendations are based on the from the office analysis of the Kosovo government.

According to the Implementing Regulation *the National IPA Coordinator (NIPAC)* should be a high-ranking official in the government or the state administration of the beneficiary country, who shall ensure the overall co-ordination of assistance under the IPA Framework Regulation.

In practice after decentralisation the NIPAC has to ensure coordinated programming, to organise regular monitoring of the IPA programmes and to carry out interim evaluation of the programmes under implementation. This means that the NIPAC should not be only a high-ranking official but he/she should be supported by a relatively strong secretariat.

Taking into account that donor coordination and the coordination of IPA programming has already been placed in the Agency of European Integration (AEI); it is for time being the most reasonable body for the secretariat of NIPAC. And therefore it is also logical that the Deputy Prime Minister for European Integration acts as the NIPAC.

There are clear advantages for developing the NIPAC secretariat in the AEI:

- in the beginning many of the IPA projects have direct input to the EU integration process;
- the capacities have already been developed in the AEI;

⁴⁴ This Discussion Note prepared by Dragan Tilev is a by-product of the work the two authors put into preparation of the “*Absorption for EU pre-accession funds: Concept and Implications for Kosovo*” analytical paper.

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- it is well established that programming is clearly separated from programme implementation.

According to the Implementing Regulation the *Strategic coordinator* should be responsible to or at least liaising closely with the NIPAC. The strategic coordinator does not have any direct functions until Kosovo becomes a candidate country and has moved to DIS. The main task of the strategic coordinator will be to coordinate the IPA components III (regional development) and IV (human resource development) between each of these and with other government strategies and programmes.

In Kosovo there are two relevant alternatives for the post of the strategic coordinator:

- Agency for European Integration (a high ranking official in the AEI, someone else than the NIPAC)
 - Advantages: very close cooperation between NIPAC (in case it is together with the AEI) and the strategic coordinator.
 - Disadvantages: less coordination with other government strategies and programmes.
- Ministry for finance and economy (the permanent secretary)
 - Advantages: good coordination with other government programmes and the necessary analytical support in the area of macro financial projections and economic development.
 - Disadvantages: may be difficult to ensure the ‘quasi hierarchy’ where the strategic coordinator needs to report to the NIPAC (which is different from PS Minister).

According to the Implementing Regulation, also the *National Authorising Officer* should be a high-ranking official in the government or the state administration of the beneficiary country.

In general, the NAO will act as the head of the National Fund, bearing overall responsibility for the financial management of EU funds in Kosovo. He or she will also be responsible for the effective functioning of management and control systems not just in the National Fund but also in all other operating structures related to the management of IPA. The NAO should also be the person liaising closely with the Commission services.

The most logical position for the NAO in the Kosovo government structures would be the Head of Treasury in the Ministry of Economy and Finance. The only worry would be that the Treasury has still very many ongoing reforms and developments that may hinder new administrative developments in the area of DIS.

For the Commission, the NAO is the key person in ensuring that the funds are properly used and therefore the NAO is also the key person in the DIS assessment – he or she personally can influence whether the Commission would decide that Kosovo is ready for DIS or not.

Implementing Regulation foresees that the *National Fund* would be a body located in a state level ministry of the beneficiary country with central budgetary competence. Also, that the National Fund shall act as a central treasury and be in charge of tasks of financial management of assistance under the IPA Framework Regulation, under the responsibility of the NAO (later in the future logically also responsible for the management of future EU financial instruments if so decided by Kosovo authorities).

It shall in particular be in charge of organising the bank accounts, requesting funds from the Commission, authorising the transfer of funds received from the Commission to the operating structures or to the final beneficiaries, and the financial reporting to the Commission. There will be one single National Fund for all five IPA components.

Taking this into account, it is evident that the National Fund should be located within the Ministry of Finance and preferably under direct supervision of the NAO. This means that the most obvious alternative for the NF would be a unit or department of its own in the Treasury section.

There are clear advantages for this option:

- the Treasury already has experience with similar operations for other budget users;
- it is easier to use the staff resources that are already available in the Treasury;
- in the future easier liaison with other developments of the financial management system in Kosovo government (positive spill-over effects are more realistic).

The only concern would be that in the beginning in the Treasury it may be difficult to create ownership for the DIS preparations, as the Treasury has many other ongoing reforms. But this can be largely solved by creating a new unit to the Treasury sector.

According to the Implementing Regulation the *Competent Accrediting Officer* should be a high-ranking official in the government or the state administration of the beneficiary country who is clearly independent from the other implementing functions of IPA programmes.

The core task of the CAO is to issue, monitor and if necessary to suspend or withdraw the accreditation of the National Authorising Officer and the National Fund. Both issuing and monitoring of accreditation means that the CAO needs to rely on some kind of systems' audit capacities.

It is recommended to nominate as the CAO someone from among high-ranking officials in the Ministry of Economy and Finance. The most logical alternatives in Kosovo could be:

- the Minister of Finance
- the Permanent Secretary for the Ministry of Finance

Taking into account that both the minister and the Secretary for the ministry have clear responsibility also over quick and smooth implementation of IPA programmes it is important to give the mandate to assist the nominated high-level official in the functions of the CAO to a person who has not been involved in the management of IPA programmes (an adviser).

There are some advantages in giving the role to the minister, as this places the minister (who is anyway ultimately responsible for the use of state finances) also to the IPA hierarchy with a clear role.

In the decision to nominate the CAO it is also important to think of a proper (and independent) back office, as a high-ranking official usually cannot be presumed doing also all the necessary analytical and paper work. The most logical support team could be within the Audit Authority (although in principle the CAO could be supported by another group of auditors); therefore it can be recommended to view the role of the CAO together with the designation of the functions of the Audit Authority.

The designation of the tasks of the *Audit Authority* may be viewed together with the position of the Competent Accrediting Officer.

The Audit Authority shall be responsible for verifying the effective and sound functioning of the management and control systems. This has to be done regularly and reported to the European Commission and the Competent Accrediting Officer. Audit Authority has to give its opinion also to the closure of IPA programmes.

The placement of the Audit Authority depends also on the development regarding the PIFC policy but in any case the Audit Authority should be situated in the Ministry of Finance (in a separate line of management from the future NF and the CFCD). Taking into account that the Audit Authority should have the mandate and the competencies to audit also other ministries and other administrative authorities, it is more logical to have the small unit of Audit Authority together with the Internal Audit Department of the Ministry of Finance. The future tasks of the Audit Authority may provide for a good input also for the Central Harmonising Unit (unit that would coordinate methodological work of internal audit in the government). Therefore some kind of cooperation procedures with the CHU should be considered.

The operating structure (CFCD and SPOs) shall be responsible for managing and implementing the programmes concerned. In some more details this means project management, tendering, carrying out project competitions, contracting, payments to the contractors or beneficiaries, project monitoring, reporting to the NAO and the NIPAC etc. By operating structures it is basically meant that for each IPA component the government would have designated an implementing agency and nominated the person in charge (Programme Authorising Officer - PAO), who reports primarily to the NAO.

Out of the five IPA components referred to above, the first (institution building) and the second (cross-border cooperation) are already now available for Kosovo and these programmes are implemented in a centralised (de-concentrated) manner, meaning that the EC delegation in Kosovo will act comparably as the national fund and the implementing agency for these programmes.

The IPA components III (regional development), IV (human resource development) and V (rural development) will be available for Kosovo after it becomes an EU candidate country and when the Commission has granted DIS for the particular component concerned.

The principal question in setting up the DIS structures would be, whether the functions of operating structures (implementing agencies) should be centralised or should these be set up in a decentralised way and so that these would be placed within the bodies that have the relevant sectoral competencies. In short the basic alternatives are:

- to create a strong CFCD for all IPA components together with sectoral project and programme implementation units in the ministries or agencies;
- to agree that the CFCD will become the implementing agency for some of the components of IPA (e.g. components I – IV) and there is another agency or several agencies for some of the components;
- to leave for the CFCD only the management of component I of IPA and to create separate implementing agencies for other components.

Based on the analysis carried out in Kosovo and taking into account the specific features of the various programmes, the first recommendation to the Kosovo authorities would be that the

CFCD is created primarily for coordinating the implementation of projects under IPA component I. The CFCD should prepare itself also for potentially becoming the implementing agency for the components II, III and IV. This should be taken as a real alternative while the other implementing bodies are developed in the various agencies and directorates. While at the same time strong programme implementation units (PIUs) should be created in the relevant agencies and directorates to build the potential that by the time of candidacy or at some point later these agencies or directorates can become the implementing agencies for some of the programmes.

These sectoral PIUs should do this type of work (organise grant competitions, manage relations with beneficiaries) in any case in their daily routine in respect to similar measures financed from the state budget. And even if the CFCD is the official implementing agency for several components, it should cooperate closely and rely on the work of these sectoral PIUs.

The IPA component V (rural development) should not be under the management of the CFCD even in the beginning due to the very specific features of the rural development programmes. For the component V it is recommended that a separate IPARD agency will be created under the domain of the Ministry of Agriculture, Forestry and Rural Development.

Operating structures for the five IPA components

Taking into account the arguments outlined above, the following would describe the alternatives for structures of the operating structures for the five IPA components:

Component I (transition assistance and institution building)

The Implementing Agency for the IPA component I is also known as the Central Financing and Contracting Department. The CFCD organises tendering, contracting and financial management of the contracts. The CFCD is under the responsibility of the Programme Authorising Officer (PAO). Daily liaison with the beneficiaries and projects will be organised by the Senior Programme Officers (SPOs) who ensure proper project management, commitment by the beneficiaries and who report in the IPA context primarily to the PAO (in the context of programming to the NIPAC). Please refer to the scheme in annex 1 for further context.

The Kosovo authorities have understanding that the CFCD should be created to *the Ministry of Economy and Finance*. It is recommended to create a small independent group of officials to the ministry for the early developments for DIS and then decide later (e.g. during 2009) how to form a separate department, unit or an agency under the domain of the ministry.

It is important to emphasise that by the time when the general DIS structures are finalised the PAO and the CFCD should be formed into a more permanent structures and not as a group of advisers to the ministry. This is necessary in order to create clear management structures for IPA.

Another important element of the structure are SPOs. They are responsible for the technical aspect of the operations within the line-ministries, they assist the PAO and the CFCD (before DIS the partner is the EC delegation) in the good and timely preparation and implementation of the projects and they coordinate the preparations of the project proposals of their area of

responsibility in cooperation with the NIPAC. Therefore it is needed that the SPO are supported by a small coordinating staff, often called as the project implementation unit (PIU).

The decision where and how to set up the SPO offices can differ by ministries depending on the existing structures and competences.

It is advisable to build up *strong central PIUs in every ministry* or in other major beneficiary institution (not many in one ministry). A large number of PIUs has usually led to the dilution of skills and experience related to relevant EC procedures, resulting in lower quality projects.

Operating structures for the component II (cross-border cooperation)

For IPA component II the rules are somewhat more fragmented, as there are differences if the cross-border programmes are together with the EU member states or only between the IPA beneficiary countries.

The core work of managing the CBC programmes will be done by the respective joint technical secretariats. These bodies act basically as strong project implementation units and they report to and cooperate with the respective implementing agencies of both countries concerned (in Kosovo until DIS to the EAR or the EC delegation).

In the case of programmes between IPA beneficiary countries, Kosovo government will have to set up the relevant operating structures. These do not have to copy the operating structures of IPA component I but in order to concentrate the IPA specific capacities, it is recommended to combine at least some of the tasks of other IPA components (most logically with the regional policy component or the institution building component).

A possible alternative is to combine the management of IPA components I and II while creating one very strong programme coordination unit for all of the CBC programmes to one of the ministries (*Ministry of Local Government Administration*) that would do most of the work and report to the common implementing agency.

In case of the programmes with Member states, Kosovo government will need to designate its members to the group of auditors of the particular CBC programme. It is recommended that the auditors that are nominated would at least partly come from the future Audit Authority. This would enable better coordination of audit activities and it would bring in further hands on experience to the Audit Authority as well.

Operating structures for the component III (regional development)

It is advisable to place the functions of the future implementing agency (or agencies) to some of the existing ministries (*Ministry for Environment and Spatial Planning or Ministry for Transport and Communications*).

The decision whether to leave the implementation of component III for the CFCD or not, does not have to be made immediately. This can be done after the programme coordination units have been established and when it is clearer, which institutions and managers have the capacity to be responsible for the whole range of functions foreseen for the implementing agencies.

If one of these ministries would become an implementing agency, this would mean that it would not report to the CFCD but would report directly to the National Fund (for the financial management and technical management of the programmes).

Operating structures for the component IV (human resource development)

The options for the component IV are quite similar with the approach described for IPA component III. The real difference is in substance – the bodies concerned are the ones who deal with education, life-long learning and active labour market policies. This means that the circle of potential PIU and future implementing agencies for the component is also different. The potential organisations would be *the Ministry of Education, Science and Technology or the Ministry of Labour and Social Welfare*.

It is also possible to designate more than one implementing agency for an IPA component. For the component IV it is an option that the Kosovo authorities will establish an implementing agency for education and life-long learning programmes and another implementing agency will be established for active labour market policies.

However these decisions can be done also after a year of preparations and when it is clearer how the detailed tasks of programme implementation would be divided. An alternative that is always theoretically possible is that the CFCD will act as the coordinating implementing agency and the organisations mentioned are the managers of the respective sectoral programmes.

Operating structures for the component V (rural development)

For the component V of IPA it is recommended that starting already from the beginning a separate IPARD agency would be created under the domain of *the Ministry of Agriculture, Forestry and Rural Development*. The implementation and control functions of the agricultural and rural development programmes have third particular features and the CFCD (within the Ministry of Finance) would definitely not be the most appropriate body to oversee the implementation of these programmes.

Broad staffing estimations for the DIS structure

It is important to acknowledge that at an early stage of DIS preparations, as the situation is in Kosovo, it is almost impossible to estimate the real needs for staffing for the management of IPA under the DIS. There are very many issues that could change the staffing needs depending on how these decisions will be made. After the detailed division of tasks between the different bodies in the administration have been agreed and drafted in the legislation and after some knowledge of the future IPA programmes (the type of programmes, the target groups of these programmes, the financial volumes etc), only then more reliable estimations for staffing can be made. In any case the future DIS structures require many new officials to be designated for the new tasks and in a small administration as is the case in Kosovo this really has an impact. It is advisable not only to bring in new professionals but also to use some of the qualified staff working already in the ministries.

The current staff numbers in the AEI (3 in the IPA section, there is need for at list 8-10 persons) *is not sufficient for the tasks of the NIPAC*, even that some of the more detailed work

regarding the cross-border cooperation programmes is delegated to the MLGA. This would enable the NIPAC office to coordinate the programming and monitoring of all IPA programmes and in addition to organise evaluations for some of the programmes as agreed with the Commission services.

In case the *strategic coordinator* is nominated within the AEI, there are no particular further staffing needs for these functions. It is however important that at least a part of the staff working in the AEI has good understanding and knowledge of the relevant policies and development plans in their respective area of responsibility.

Depending on the division of functions between the bodies in the IPA structures and on how the functions of the National Fund are supported by the rest of the Treasury the indicative size of *the National Fund could be between 8 and 10 officials*. This would enable to supervise, to do occasional closer checks on operating structures and to organise financial flows to the beneficiaries and the necessary reporting to the Commission in respect to all five IPA components.

In the beginning (at the DIS decision for first components) *it is enough if there are 2 – 3 full time financial managers in the National Fund*. This number can then be increased in accordance with the new programmes implemented by the Kosovo national authorities.

The number of auditors needed in the Audit Authority depends greatly on the general division of tasks between the Audit Authority and the internal audit units within line-ministries. In the beginning the Audit Authority *could operate well with 2 – 3 relatively experienced auditors*. In principle this number could be sufficient also later when programmes are mature already and when all five IPA components are under implementation. But this would be possible only when a large part of the necessary audits are carried out by the line-ministries and the Audit Authority would only coordinate the planning of the audits and would carry out audits on its own only in the areas with bigger risks and normally just to test the system.

In case the Audit Authority would carry out the necessary audits for all five IPA components by its own staff (and would not rely on the audits carried out by other ministries), it would be *more realistic to plan for 8-12 auditors for the work* (at the time when all five IPA components are under DIS and the programmes are being implemented for some time).

In case the CFCD will act as the implementing agency for component I only, the minimum number of staff *by the time of phasing in to DIS should be between 6 – 8 professionals* with at least one full time assistant for the unit. In addition to them there needs to be a nominated PAO. The group of professionals should have 3-4 project coordinators / procurement specialists, 2 – 3 financial managers / accountants and one manager of the unit. Depending on the number of programmes *the total number of staff could increase up to 15-20 officials* with half of the team acting as project coordinators and procurement specialists.

When creating the CFCD as a separate department or an administrative body, it could be decided already in the beginning to establish within the CFCD two separate units – one with the emphasis on procurement and the other with the emphasis on financial control and payments. In this way the separation of functions is clearly established as well as the structures.

If the CFCD would act also as the coordinating and responsible implementing agency for other components, the number of staff needs to be much larger. Fulfilling the role of an *implementing agency for the component II* (cross-border cooperation) would require at least **2 additional posts**, the tasks of an *implementing agency for the components III and IV* would require depending on the volumes and the number of different programmes at least *15-20 additional officials* (while at the same time also the staff in the relevant agencies and directorates managing the programmes should be almost at the level as the agencies would be implementing agencies themselves). Even if the CFCD would be the central implementing agency for most IPA components, it would in any case rely heavily on the work of different sectoral agencies and directorates. Therefore these additional professionals that would be needed in the CFCD would not be equally saved in the agencies and directorates.

In case the *SPOs' offices* have the task of coordinating the ministry's projects under component I only the needed numbers of staff are not that demanding. In addition to the nominated SPO (who does not have to be necessarily full time for IPA) *1 – 3 full time project coordinators should be sufficient*. This depends largely on the number of projects in the domain of the ministry. The potential number of staff is not that big, as typically there are further officials in the various departments who deal with the projects as direct beneficiaries. The task of the *SPOs' offices* is to coordinate the implementation of the projects and liaise with the CFCD and the secretariat for NIPAC.

In case the *SPOs' offices* also coordinate the preparations for future implementing agencies under the responsibility of the ministry concerned, it might be necessary to strengthen the staff with some further officials. The same applies if the *SPO's office* is coordinating the preparations of the future sectoral operational programmes for the different IPA components.

Alternatively the *SPO* might also rely on the work of the project coordinating units in the competent agencies and directorates. In this case the *SPO* might need only an assistant and the substantive supporting work of the *PIU* would be done by the respective agency or directorate.

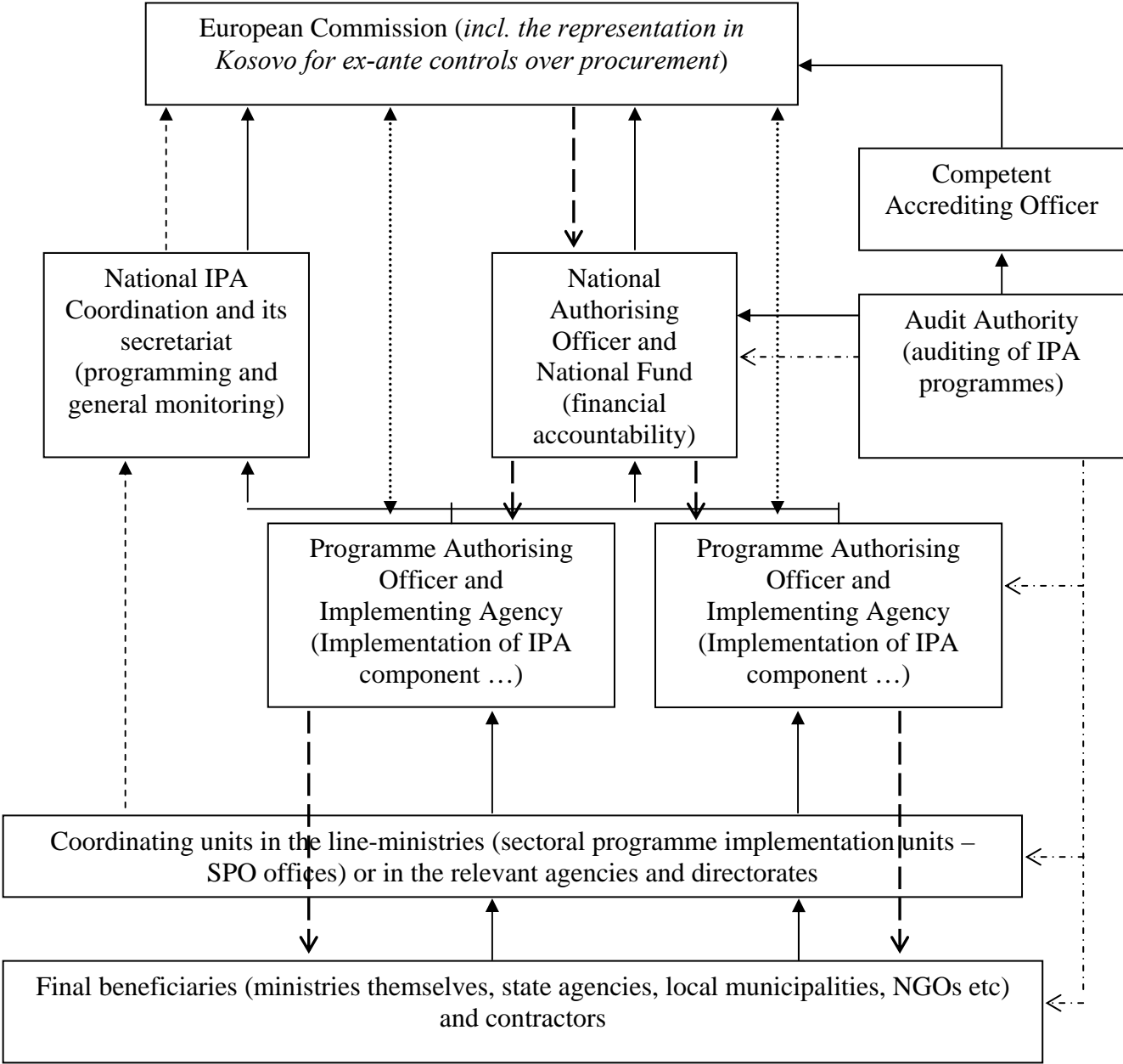
The management of *the sectoral programmes* (SME support, environmental protection investments, life-long learning measures, active labour market measures etc) is relatively more human resource demanding than the implementation of the component I. The measures are directed to different target groups and the number of projects is normally much larger. (the single projects are at the same time usually smaller)

In case the Kosovo authorities decide to set up one *single implementing agency* for the *component III (regional development)* the potential number of staff during the implementation of programmes *could be between 20 – 30 depending* on the features of the programmes and the financial volumes.

If the Kosovo authorities will set up one *single implementing agency also for the component IV (human resource development)* the number of staff needed for these tasks could be *between 15 – 20 officials*. The financial volumes of the component IV are most likely much smaller than the budget of the component III but the single projects are smaller and the beneficiaries need more daily support. But again it is important to note that before the main features of the future human resource development programmes are not known, the staffing estimations can be merely illustrative.

The agencies for rural development and agricultural support measures have traditionally had very large numbers of staff, as the projects are typically small and the type of projects requires intense and frequent controls. It can be estimated that in the beginning the number of staff in *the IPARD agency should be at least 40-60 officials*. This would enable to run the rural development measures with all the financial control elements and on-the-spot verifications needed. As the programmes mature and more and more projects are financed, the *number of staff could be increased up to around 120-150 officials* (some of them could work in regional offices). This however should be kept as an absolute maximum until the administration will start benefiting from the post-accession support measures.

Graph: Schematic overview of the hierarchical structure for DIS according to the requirements set in the Implementing Regulation



———→ Reporting; - - - - -→ project proposals; - - - - -→ payments;
 <- - - - -> Procurement - - - - -> auditing
 <- - - - -> Ex-ante control