

SIPU report for the Swedish International Development Agency (SIDA)

Under contract 'Advisory Services for EU – Ukraine, Sida ref: 2007.002743'

Date: 5. May 2008

REF: SIPU/JMWEN ASS. 01-rev1

Authors: Alan Mayhew and Kevin Prigmore

Co-financing of assistance between the European Union (Commission) and a member state

The Paris Declaration on aid effectiveness underlines the need for donors to coordinate their aid far more closely. Donors have committed to make full use of their respective comparative advantage and to work together to harmonise separate procedures.

The Swedish Government has expressed its intention to co-operate fully with the European Union (European Commission) and other bilateral EU donors in order to increase efficiency as required in the Paris Declaration. The Government has also underlined that Swedish aid should serve the general purpose of increasing the visibility of the European Union in the partner countries.

Co-financing between the European Commission and the member states has occurred on occasions in the past. However the subject has recently been relaunched through the agreement on the Paris Declaration and the EU Code of Conduct on Complementarity and Division of Labour in Development Policy. The Commission is keen to cooperate with the member states.

In the context of the European Neighbourhood Policy Instrument (ENPI), the ENPI regulation expressly emphasises the need for member states and the European Union to coordinate policy on assistance, and article 17 outlines the possibilities for co-financing.

Sweden is a major bilateral donor to Ukraine (around EUR 12 million annually). The EU is the largest external donor granting around EUR 140 million per year to the Ukraine over the period 2007-2010; Sweden of course contributes substantially to this amount too through the General Budget of the European Union. Both of these sources are grant financing; though loan finance is available through the EIB, the World Bank and the EBRD (also equity participation). The assistance can be cofinanced by the partner country.

The substantial allocation of Swedish funds to Ukraine means that Sweden should play a major role in the debate on EU assistance policy to Ukraine. In achieving this heightened role, Sweden will also be able to further its own policy towards Ukraine and that country's future integration with the EU.

Forms of cooperation in financing with the European Union

At least three possibilities of cooperation with the European Union can be envisaged:

- Better coordination of assistance amongst the member states and the European Commission (ideally done by the partner country) and a continuation of bilateral funding respecting the Paris Declaration
- joint co-financing
- parallel co-financing

or of course a mixture of these.

The track record of EU coordination is not something to be proud of, but that is no reason to give up. The main problem in Ukraine may be the inability of the Ukrainian authorities to coordinate foreign assistance and to gear it to the priority needs of Ukraine's national development.

Joint co-financing is the system which is being highlighted by the European Commission. Under joint co-financing, one donor is selected as the lead donor, and the other donors transfer their aid to the lead donor. Total control of the assistance programme lies with the lead donor, the other contributors becoming essentially sleeping partners, but with rights of overview. The procedures for implementation of the assistance are either those of the partner country, or where this is not possible, those of the lead donor.

Given that the European Commission is by far the major donor in Ukraine, it is most likely it will be the lead donor in joint co-financing. From the point of view of the Commission, joint co-financing is a fairly straightforward procedure. Once Sweden has taken the decision to delegate the implementation of its financial assistance for a project in Ukraine to the Commission, the Commission takes an official decision to accept and manage the funds, which are then entered into the revenue side of the EU budget. All aspects of the project will then be discussed between Sweden and the European Commission to ensure that Sweden accepts the project design and the implementation modalities. Once there is agreement the project will be implemented using the procedures and rules of the European Community.

From the Swedish side there may be legal, financial and auditing conditions which have to be met to allow the delegation of funds to take place. SIDA needs to check on this.

The advantages of **joint co-financing** are obvious:

- Given the relatively low staff numbers involved in the implementation of SIDA projects in Ukraine, the delegation of funds to the European Commission ensures that they can be applied in a way which meets the objectives of the Paris declaration and the EU code of conduct. It

should however be noted that in joint co-financing a human resources issue will arise. The lead donor will probably require additional human resources to be provided by the co-donor(s). This could be achieved for instance by the co-donor putting a detached national official into the EU Delegation.

- SIDA is relieved of the necessity of going through tendering and procurement procedures in the implementation of its funds
- Swedish funds contribute to the European Union image in Ukraine
- In the discussions with the European Commission, Sweden can influence the way in which Union funds are used in Ukraine.
- The consistency and coherence of EU + Member States' assistance to Ukraine might be increased

There are however certain disadvantages in joint co-financing:

- The most important potential disadvantage is that Commission-managed programmes are generally large, bureaucratic, and slow in implementation. In most of the European recipient countries they have therefore a mixed reputation. Bilateral programmes on the other hand can be far more flexible and more able to deal with rapidly changing priorities of the partner country. However under ENPI, most of the funding will be in the form of sectoral budget subsidies or implemented through the TAIEX and Twinning programmes, and therefore this criticism may have less validity.
- Once joint co-financing is agreed, the combined funds are treated simply as Commission financing. It will therefore appear to the Ukrainian side simply as part of overall Commission funding. This will make it more difficult for Sweden to demonstrate to the Ukrainian side the high level of Swedish funding and importance which Sweden gives to helping Ukraine. Naturally the publicity around the programme can make it clear that the money is both from the European Union and Sweden.
- Tendering, procurement and all other rules relating to the joint co-financing will be those of the European Community and in particular those contained in the ENPI regulation. This should normally not be a problem but there may be specific Swedish concerns here.
- The ability of Sweden to influence Commission assistance to Ukraine will depend on the extent to which the Commission services are prepared to discuss the joint co-financing in detail.
- As with all forms of co-financing between Euro-Zone donors and those outside the Euro-Zone, there may be a certain exchange-rate risk as the co-financing projects will be denominated in Euro.

It is of course also possible that Sweden becomes the lead donor in a project, and the European Community financing is implemented by SIDA. In this case the rules used in the implementation of the project would be those of SIDA.

The key step here would be an ex-ante assessment to ensure that SIDA rules comply with the European Community's financial regulation (see JMWEN note on Commission assessments of lead donors under indirect centralised

management). This assessment only needs to be carried out once but the procedure requires at least 6 months. Where the EU is the delegating donor, the EC financial regulation will still apply and therefore EC controls and auditing will probably be additional to the Swedish procedures. The responsible Commission services may not have the same view on these issues as the Commission's management services or Swedish audit authority.

Parallel co-financing is also possible. In this case a project is financed by two donors but their financial contributions are managed separately according to their national rules. In this case Sweden and the European Community (or other member state) would agree on their financial contributions to a particular project, each managing an identifiable part of the project, and applying their own rules to their own part.

The advantage of parallel co-financing is that it more clearly emphasises the cooperation at the EU level and that each contribution is clearly recognizable for the partner country. In cases where the EU provides only budgetary support, the Swedish assistance could be in the form of technical assistance, providing good synergy, and a multiplier effect. This would heighten the profile of SIDA as a donor.

The comparative advantage of SIDA, with its ability to react rapidly and flexibly, will provide real added value to Commission programmes, which have large resources, but relatively rigid procedures.

The disadvantages of parallel co-financing are obviously liable to occur in the coordination between the donors and the potential confusion caused by the use of different tendering and procurement rules. Probably for these reasons parallel co-financing does not seem to be prominent in the minds of those involved in the Commission, but this is not a reason to eliminate it as a possibility.

Sweden may want to consider the long term legal implications of allocating some of its assistance money to the Community. Before the Court of Justice, the Commission frequently uses precedents to justify extensions to its competence.

EU experience with co-financing

The European Commission does not have experience using the rules of joint cofinancing, the whole legal basis for this to take place having only been recently decided. The first example, which is under way, is a very specific project to assist the Palestinian territories and is unlikely to give us a reliable guide to how this will function in Ukraine.

Sectoral budget support

Sectoral Budgetary support has been used by the Commission in Africa, and in a similar form in the new Member States under the Schengen facility.

Budgetary support can be disbursed to the national treasury either in untargeted, meaning mixed EC and domestic revenue, or in a targeted manner to fund certifiable expenditure, Funds will also be available for complementary support, such as capacity development, institutional support etc.

It is difficult to assess the appropriateness of the models used in Africa. In Europe, the 'Schengen' model was used in countries with effective Government controls in place and a rigorous public financial management system and with the Commission's Extended Decentralised Implementation System (EDIS) Accreditation. The Polish version of the Schengen documentation was based firmly on the methodology of Phare and Structural Funds programme and project implementation of certified expenditure.

Sector policy support programmes and general budget support are the chosen aim of the EU is providing assistance to countries such as Ukraine, as long as they meet the conditions set.

Advantages

The budgetary support will directly benefit the Ukrainian Government. The EC will not carry out financial audits of untargeted budgetary support, transferring the burden for Audit to the Ukrainian Authorities, once it is disbursed to the national Treasury. The Swedish Authorities will need to determine if this is compliant with their public finance laws and regulations

Disadvantages

There would appear to be little added value to the addition of SIDA funds to budgetary support, which currently will offer more than EUR 80 million annually of support to the Energy sector of Ukraine.

The Commission and Ukrainian Government are still preparing the scheme.

Management by results may be difficult to incorporate into the budgetary support system, if a direct output/outcome link is required.

Recommendations

Potential SIDA projects using cofinancing could be:

- Utilize a support mechanism established for EU funds: Provide SIDA funds to the EC sustainable regional development fund, due to start in June 2008. SIDA could provide funds through a Structural Funds type mechanism to recipients in the regions, A similar joint arrangement could work with other bi-lateral donors' projects,
- EU Budgetary support: SIDA could provide Technical Assistance to support the Commission's initiatives in the energy sector.