



# REPORT

THE POLISH INSTITUTE OF INTERNATIONAL AFFAIRS

## LEARNING FROM PAST EXPERIENCES: WAYS TO IMPROVE EU AID ON REFORMS IN THE EASTERN PARTNERSHIP

WARSAW  
APRIL 2014

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Warsaw, April 2014

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The research leading to these results has received funding from Fritz-Thyssen Foundation within the framework of the project “Strengthening the capacity of Eastern Partnership governments to absorb EU financial assistance – review of institutional gaps and needs for intervention”. The Polish Institute of International Affairs would like to thank Fritz Thyssen Foundation for its support.



ISBN 978-83-62453-79-5

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## Abbreviations

AA—Association Agreement

CSOs—civil society organisations

DCFTA—Deep and Comprehensive Free Trade Agreement

EaP—Eastern Partnership

EaP CSF—Eastern Partnership Civil Society Forum

EaPIC—Eastern Partnership Integration and Cooperation Programme

EC—European Commission

EU—European Union

GONGOs—government-organised nongovernmental organisations

GTZ—German Organisation for Technical Cooperation

MEI—Ministry of Economy and Industry

MF—Ministry of Finance

NGOs—nongovernmental organisations

OSMEI—Office of the State Minister of Georgia on European and Euro-Atlantic Integration

PAO—Programme Administration Office

PFM—public financial management

SAARES—State Agency for Alternative and Renewable Energy Sources

SBS—sector budget support

SME—small and medium-sized enterprises

TA—technical assistance

UNDP—United Nations Development Programme

VET—vocational education and training



## Glossary

**Association agenda**—a new, practical instrument that replaces the Action Plan in countries and which prepares them for and facilitates the entry into force of an Association Agreement. It includes concrete objectives of cooperation between the EU and the partner country.

**Action plan**—a document signed between the EU and partner countries that includes objectives of cooperation.

**More-for-more rule**—a situation in which the EU offers additional incentives to countries as they make further progress towards democratic reform.

**National allocation**—the amount of money to be committed by the EU bilaterally with partner countries during the given budget period (i.e., the EU's "financial perspective").

**Public Financial Management**—the entire national budget cycle, including revenue administration, budget preparation, budget execution with cash management, procurement systems, internal controls and internal audits, accounting and reporting, external audits and scrutiny.

**National indicative programme**—a document presenting EU strategic goals of cooperation for a partner country for a three-year time span.

**Policy matrix**—part of the financial agreement of the budget-support operation, including conditions.

**Technical Assistance**—EU advisory services.

**Twinning**—a type of EU advisory service involving experts from the missions of EU Member States.



## Executive Summary

The EU aid approach in the Eastern Partnership countries is to financially support concrete reforms: sector budget support operations are most commonly used. The pace of fulfilment of conditions differs much among the partners. This results mainly from the various levels of willingness of the EaP governments to conduct EU-oriented reforms. Therefore, one can distinguish two groups of countries, EU-oriented (Moldova, Georgia) and non-EU-oriented (Armenia, Azerbaijan), where the latter are interested only in selective sector cooperation. The status of Ukraine is still unclear due to the recent political crisis: a pro-EU government is in place but the country will soon face presidential elections and is generally under increasing pressure from Russia. Still, in analysing recent years under the presidency of Viktor Yanukovich, the country was not committed to EU integration in real terms.

A comparative picture of budget-support use in five Eastern Partnership countries shows numerous similarities. The initial experiences prove that it helps with legal approximation to EU standards in various sectors. This makes budget support, based on conditions and results, a more efficient tool in guiding some sector reforms than purely advisory instruments. For EU-oriented countries, budget support is a suitable tool to guide the reforms needed to follow the association agenda. For non-EU-oriented countries, budget support cannot be an instrument that will encourage the government to start comprehensive reforms, but can be used as partial support in some sector cooperation. In that case, it has a fundamental advantage of obliging the government to work closely with the EU, going to the substance of the reform, and change, at least partially, the situation. In order to make budget support a more effective tool, several challenges common to the EaP countries must be addressed.

The biggest problem with this approach appears to be that budget-support operations enhance legislative changes while failing to address the implementation side of reform, that is the government measures and actions aimed at the introduction of relevant policy instruments, procedures, and institutional interactions in order to achieve the planned reform. The reasons for this, besides political unwillingness, are as follows. First, the engagement of relevant ministries in implementation is lower than it could be as the funds are directed to the state budget and not to them directly. Second, the conditions applied to the aid sometimes are not shaped properly (they are too broad, ambitious or numerous). To some extent, this is derived from the limited capacities of national administrations to draft conditions and the inexperience of both sides in their first operations together. The programming period lacks wide consultations with stakeholders, other than the government, to discuss if the selected conditions are the most relevant. In addition, budget support is highly inflexible in terms of changing indicators once the financial agreement is signed, which risks outdated conditions. In some cases, the EU side is mainly to blame, as it avoids calculations of the overall costs of reforms and linking concrete activities with money as it fears the aid it provides would be treated as insufficient by the beneficiary.

In the majority of the EaP countries, weak public administration seems to be a factor that hampers implementation, and EU technical assistance only to a limited extent supports capacity-building of administration because of untimely launches. Special notice must be paid to the system of budget-support coordination at the EaP country level. One lesson learnt is that a crucial stakeholder in the process should be the Ministry of Finance, as it is the direct beneficiary of EU money, has financial leverage over line ministries, and manages public finances and ensures transparency in their use. One has to make sure that budget support is not used to serve the country's obligations but rather that it is directly transferred to the appropriate bodies responsible for the implementation of reforms agreed with the EU. Another issue is also the lack of monitoring mechanisms (by civil society and the administration itself) in the implementation of budget

support at the national level. This results in a situation in which it is difficult to collect the required information and data about each ministry's performance.

A factor in common is the low social endorsement and visibility of EU-supported reforms, which results in low social pressure on the government to enact them. There is very little involvement of watchdog groups that would monitor implementation, and in most cases (besides Georgia) the representatives of CSOs are either not invited to participate on the monitoring committees and have limited access to information or their participation is only *pro forma*. Last but not least, the results of the reforms are poorly communicated, usually by press releases, and additional communication activities are rarely undertaken.

Specifically in relation to the non-EU-oriented countries (Armenia, Azerbaijan and Ukraine), the main hurdles in the use of budget support is a problem with fulfilling the general condition on transparency of public financial management. Moreover, the EU's role in directing the whole reform process is very limited as the partners are reluctant. It can be seen in all of those countries at the middle management level that some officials are interested in cooperation with the EU and some sectors of common interest might be found, but nothing can be done without a decision from a higher political level. The question is then how to upgrade actions at the higher level and what role the EU should take in responding to these willing partners.

**Given the challenges noted above and with the aim to improve the efficiency of EU aid for reform, the following steps may be undertaken:**

**In order to upgrade EU support at the higher political level in the EaP countries:**

- Budget support should be used in a clear manner by the EC as a tool through the use of the “more for more” rule and differentiation approach. Countries eager to undertake reforms, namely those aiming to sign an Association Agreement, including DCFTAs, should be granted significantly more financial resources via budget support. Decisions about the allocations to relevant countries should be explicitly explained to the wider public.
- Bearing in mind its financial constraints, the EU should, to a greater extent, coordinate support with international financial institutions and other donors. An example of this is coordination on regional development reform in Georgia.
- In order to involve the ministries to a greater extent in fulfilling the conditions of support, they should receive some financial resources to help complete reforms. To this end, the EU should include the condition that some percentage of funds be transferred to line ministries.
- The involvement of all crucial parties in the reform process in joint monitoring committees should be ensured.
- Planned operations should be consulted at a very early stage with various stakeholders, such as parliamentarians, CSOs, and other interest groups, in order to secure broad social support for the reform. Obviously, opportunities to hold such consultations would differ for each EaP country because of their various levels of democracy.
- In order to reach different groups and not just the government, budget support should be complemented by other EU aid tools, such as grants and contracts for international organisations. The best practices from budget support for the Georgian agricultural sector might be replicated in this respect.

**In order to increase the social endorsement and visibility of the supported reforms, communication should be developed. To this end:**

- Budget-support implementation should be made public and communicated regularly to media by the EU delegation. In terms of the public message, information about budget support should not be focused on publicising data about the amount but on the positive changes as a result of measures taken by EU aid reform. The best practices from budget support for transport in Ukraine may serve as an example here.
- Social interest should be increased through the involvement of major decision-makers. Based on experience with Moldova, whenever a financing agreement is signed, a large public event can be organised with the participation of the prime minister or president. Also, the head of the EU delegation or the line minister could regularly and jointly present the results of a given reform effort.
- Regular press releases on fulfilment of programme criteria should be sent out to a wide audience, including media.

**In order to ensure financial resources are not fraudulently used, transparency must be increased for both the EU and EaP partners:**

- The EU should demand more strict enforcement of proper public financial management by the EaP partners and be coherent in this respect: no new support for a government should be launched unless the country has taken serious steps in order to implement its PFM strategy. In case this does not happen, other aid tools should be chosen, i.e., projects, grants, support for civil society.
- Information about the implementation of budget support (involving any problems related to its performance) and policy matrix (parts of a financial agreement including conditions) should be translated into reader-friendly language and published on the EU delegation's website. Moreover, based also on the experience with Moldova, national administrations should be encouraged to create a database that would help to make external assistance more visible.
- Sector CSOs should participate in joint monitoring committees, and in case of beneficiary resistance, the EU should include conditions for such into financing agreements. The best practices in Georgia might be followed here.
- The EU should finance watchdogs that can monitor public financial management and support reform implementation.
- As CSOs now have limited involvement because their sector is weak, the EU should push harder for the creation of a favourable legal environment for CSO development in the EaP region.

**In order to make budget-support conditions more effective in bringing about implementation of the reforms:**

- The EU should narrow the supported areas, perhaps even choosing a cluster within a specific sector that might serve as a “pressure point” leading to improvement in the sector overall. Due to limits in supporting comprehensive reforms in non-EU-oriented countries, budget support can be used to cover reform of certain economic activities or institutions of particular importance for such countries.
- Conditions should focus on implementation of the reforms, not only the adoption of required legislation “on paper,” and these conditions should be made as precise as possible. A best practice from energy sector operation in Moldova could be followed here: detailing a percentage link between specific targets achieved and the amount of the subsequent and

corresponding tranche to be transferred results in a very accurate and measurable setting. Moreover, as with later tranches, the first fixed tranche should have a set of conditions to motivate the administration to fulfil their duties in the very early implementation stage.

- The EU should help EaP administrations assess the costs of relevant reforms and, accordingly, propose financial support to sustain the link between money and activities.
- Technical assistance should be commissioned prior to budget-support negotiations in order to involve external experts in the process of programming and drafting of indicators (pre-feasibility studies) and they should last for the entire cycle. This would enable the involved cadres to receive training in time.
- In order to strengthen expertise, more local experts from Eastern Partnership countries should be contracted in the scope of technical assistance activities and the EaP administration should be more involved in the selection of these experts.
- EU bureaucratic procedures must be made more flexible in order to react to changing political priorities. Therefore, financial agreements (i.e. the policy matrix) should be made flexible and allow for on-the-fly updates of conditions in line with actual developments. Moreover revisions should be made between tranches—a mid-term review between the second and third tranches should be conducted in order to assess if the conditions are still relevant.

**In order to enhance the capacity of the national administration to offer budget support:**

- Technical assistance should not fulfil the duties of the national officials (i.e., drafting monitoring reports that should be delivered by the national administration) as this limits building the analytical capacities of the administration. A good solution would be to support some aspects of public administration reform, including building up a civil servant training system with a greater emphasis on long-term training for top- and middle-level civil servants.
- In order to increase the officials' knowledge about budget support, general methodological materials in the national language (FAQs) should be prepared, and introductory training and seminars referring to lessons learnt in the current budget period ("financial perspective") should be conducted frequently by the EU Delegation and the EaP coordinator.
- In terms of EaP coordination of budget support, the EU should insist on involving the Ministry of Finance in the process. Technical assistance should help build up interministerial cooperation on the respective reforms as well as create a system for budget support monitoring by involved institutions. These issues should be made conditions and written into financial agreements.
- In order to enhance the process for drawing lessons from other countries' experiences in the implementation of budget support, technical assistance should include exchanges with relevant officials from countries with best practices. For instance, in the field of transparency, the lessons learnt in Moldova and Georgia might be worthwhile.

## Introduction

Nearly five years into its existence, the Eastern Partnership (EaP) is facing unexpected and dynamic developments. This EU policy, established in May 2009, has been building up relations with partner countries Armenia, Azerbaijan, Belarus, Georgia, Moldova and Ukraine in negotiations on new Association Agreements, including Deep and Comprehensive Free Trade Agreements (DCFTAs) and deals on visa issues. While it seemed the EU's offer should be attractive for the majority of these countries, some have their minds set on a different approach. Belarus and Azerbaijan, both undemocratic and not members of the World Trade Organisation, which makes them ineligible for DCFTAs, have remained reluctant in terms of stepping onto the integration path with the EU and instead have focused on visa issues. Georgia and Moldova, both with pro-EU governments, have eagerly rushed to meet EU criteria, initialled Association Agreements during the Vilnius summit in November 2013, and have progressed significantly in order to obtain a visa-free regime with the EU. Meanwhile, two countries that traditionally have pursued a policy of balance between the EU and Russia—Armenia and Ukraine—withdraw from negotiations with the EU, turning towards Moscow instead. In September 2013, Armenia announced it had chosen to integrate with the Russia-led customs union. Two months later, Ukraine stopped progress towards signing an AA with the EU in the very last moment of the negotiations, which resulted in massive citizen demonstrations, a prolonged internal crisis and a change of government in March 2014. As a result of the recent changes, Ukraine changed course and signed the political part of the Association Agreement on 21 March 2014 and is back on an EU path. These various choices mean the Eastern Partnership countries are much more diverse in terms of their ambitions to strengthen relations with the EU.

Yet even before these courses had been set, it had been increasingly clear that the EU—through the EaP and as an entity—is failing to become an attractive partner in relations with its neighbourhood. Imposing upon its partners its own political vision using strategies replicating the enlargement model simply does not work if EU membership is out of the question and bearing in mind that not every neighbour is interested in the EU way. Therefore, it seems the EU should search for ways of making its vision more explicit. To this end, the EU needs to diversify its tools of influence to better fit reality. Financial support supplemented by conditionality is one of the main instruments at hand, and therefore must be tailored to a new situation. It is evident that countries that are going to implement new trade deals must be targeted by assistance that is relevant not only in terms of volume but which also fits their needs. Partners that prefer selective sector integration should not be left out, either, but rather offered options to pick up with a relevant level of conditionality.

In order to find ways to have more balanced relations with the Eastern Partnership countries, this report takes a look back at EU practices for supporting the reforms delivered by EaP governments in the years 2007–2013. **The EU tool used for this purpose is budget support—financial assistance paid directly to the state budget of a beneficiary country conditional on its performance with reforms.**

The majority of bilateral national allocations from the EU to a particular eastern partner are channelled through budget support. Other EU aid tools (such as cross-border cooperation, civil society support, etc) are not the subject of this research as they are not directly linked to impacts on the reform pace. This report presents the results of research into budget support usage in the five Eastern Partnership countries where it is employed. The question researched is about the existing predominant barriers to the use of budget support on both sides—the EU and the EaP governments—with the aim to identify and address the gaps in the institutional scheme so as to indicate methods in which it could be improved. The assessment criteria involved the following aspects: the use of EU conditions and procedures, monitoring and transparency, visibility, and

absorption capacity. These are important in view of realising the potential of the policy objectives of the EU in the scope of EaP. In terms of tools, the research is based on an analysis of official documents and interviews with EU officials working in EU delegations in the selected countries, officials in the national public administrations, independent experts, and civil society organisation (CSO) representatives, and was carried out in Armenia, Azerbaijan, Moldova, Georgia and Ukraine between June and September 2013. In total, 90 interviews were held in cooperation with Eurasia Partnership Foundation (Mikayel Hovhannisyan, Armenia), Center for Economic and Social Development (Narmin Ibrahimova, Azerbaijan), Georgian Foundation for Strategic and International Studies (Ekaterina Meskhrikadze), Institute for Public Policy (Alexandru Platon, Moldova), Economic Reform Fund (Nataliya Kyrychenko, Ukraine). The results depict how budget support was used in Ukraine, Moldova, Georgia, Armenia and Azerbaijan. It is presented in this report by five case studies, each divided into the following sections: EU-partner country relations and priorities; a description of statistics and tendencies; the role of budget support in funding reforms and major challenges; country conclusions and recommendations. These sections are preceded by a chapter presenting the general aims and characteristics of budget support in the EaP region, the volume of support and a breakdown by country.

The research had several limits and caveats. First, due to restricted access to information about details of budget support operations, this report does not have the ambition to be an evaluation of this aid modality in terms of results obtained but aims to highlight major problems with EU budget support as perceived by the involved parties. Given the lack of publicly available information about the state of the supported reforms, in the majority of cases it is impossible to fully assess the results. Second, as the research focuses on barriers in implementation and not on presenting a comprehensive assessment of results, the overall picture might not be balanced enough. In the interviews, however, an emphasis was put on drawing as many positive lessons learnt as could be obtained.

*Elżbieta Kaca*

## The Budget Support System in Eastern Partnership Countries

Elżbieta Kaca

Here we present the general aims and characteristics of budget support in the EaP region, the volume of support and a breakdown by country.<sup>1</sup> Budget support is the predominant EU tool in the Eastern Partnership countries, as around 60% of bilateral financial resources are scheduled to be spent through such means. This comprises financial assistance supporting government reforms and paid directly to the state budget of a specified country. Therefore, it requires close cooperation between the national administration and the EU delegation, ensured by frequent communication as well as the participation of common monitoring committees.

Two types of budget support have been in use in the EaP region: general budget support and sector budget support. Under the former, funding is provided for a broad range of reforms planned by the government for a given period of time, for instance, implementation of the association agenda or action plans. The latter, sector budget support, goes for reforms only in a given sector, e.g., energy or health. Sector budget support has been the dominant form of support in all of the EaP countries except Armenia, where general budget support was employed.<sup>2</sup>

The introduction of budget support in 2007 as an additional layer to a project-based system that used external stakeholders marked a significant shift in EU relations with its neighbours. The project-based approach involved EU support through intermediaries (international organisations, CSOs, etc.) on concrete activities in the beneficiary country. Such an approach enabled control by the EU over the financial resources and decisions about priorities. With budget support, partner countries were entrusted to undertake reforms with funds that were sent directly to their accounts, but this came with the introduction of greater conditionality. This shift was a consequence of a global trend in EU development policies, advocated by nongovernmental organisations.<sup>3</sup> Indeed, unlike the project approach, direct budget support theoretically has numerous advantages. It implements the partnership principle to a greater extent since the priorities of the supported reforms are agreed jointly by officials from the EU and the given country at a higher political level. Funds are transferred directly to the state budget, so the assistance is linked with the current political reform agenda. Moreover, budget support minimises transaction costs in the form of administrative costs of numerous intermediaries implementing projects as well as the costs of EU staff to supervise them.

The overall goal of budget support is to contribute to poverty eradication, sustainable and inclusive economic growth, and the consolidation of democracy. In the Eastern Partnership region, reforms related to all three goals are supported (Table 1). Priority is given to economic growth in

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<sup>1</sup> The legal basis on which budget support operates is Regulation (EC) No. 1638/2006 of the European Parliament and of the Council of 24 October 2006, laying down general provisions establishing a European Neighbourhood and Partnership Instrument, <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:32006R1638:EN:NOT>.

<sup>2</sup> The breakdown between the two types of support is presented in the section about Armenia on pages 37–40.

<sup>3</sup> Budget support is fully aligned with the principles and commitments made in the Paris Declaration on Aid Effectiveness (2005), the Accra Agenda for Action (2008) and the Busan Partnership for Effective Development Co-operation (2011).

each country, while consolidation of democracy was mainly supported in Georgia and poverty eradication in Moldova. As the priorities seemed to be rather too many, which resulted in limited impact, the EU decided that in its next budget cycle (“financial perspective”) each country would receive support for only three sectors. For the EaP countries, this would better link the Eastern Partnership objectives with EU aid and make it more focused, which currently is not the case.

**Table 1. List of reforms supported by budget support operations in the EaP countries in 2007–2013**

Country EU objective	Moldova	Georgia	Ukraine	Armenia	Azerbaijan
Poverty Eradication	Social Assistance Health Water	Conflict Affected/ Displaced Population and Host Communities		Food Security Programme	
Sustainable and Inclusive Economic Growth	Economic Stimulation in Rural Areas Energy Vocational Education and Training Visa Liberalisation Process	Vocational Education and Training I Regional Development reform I Agricultural Development Regional Development reform II Border management and migration Vocational Education and Training II	Energy Energy Efficiency Removing barriers to trade Environment Transport Border Management	Vocational and Educational Training Multi-Sector Budget Support I Multi-Sector Budget Support II EaPIC—upgrade of VET programme Agricultural and Rural development EaPIC—upgrade of MSBS 2011	Energy Agriculture Rural regional development
Consolidation of Democracy	Justice	Public Financial Management I Criminal Justice Reform Public Financial Management reform II Criminal Justice Reform II Public Financial Management reform III		Justice reform I Justice reform II	Justice

Source: The Polish Institute of International Affairs, 2013.

The supported policy areas were chosen on the basis of a lengthy programming period (lasting up to 1–2 years), involving consultations with the EU and negotiations with the recipient country.<sup>4</sup> The EU decisions about the allocation of the amount of money and choice of concrete reforms seem to depend on a whole range of factors: EU political priorities, the development priorities of a given country, the European Commission’s track record in cooperating with the recipient and its capacity to support relevant policies. Some additional money is given on the basis of the “more for more” rule, whereby countries that perform the best in making democratic

<sup>4</sup> See the details about EU programming in the *Court of Auditors Special Report No. 13/2010, “Is the new European Neighbourhood and Partnership Instrument successfully launched and achieving results in the Southern Caucasus,”* available at <http://eca.europa.eu/portal/pls/portal/docs/1/7896724.PDF>.

reforms gain additional aid. Accordingly, during 2011–2012, the eastern neighbourhood received €130 million through the Eastern Partnership Integration and Cooperation Programme (June 2012). Moldova, Armenia and Georgia were granted additional aid.<sup>5</sup>

Among the Eastern Partnership countries, the highest amount of money was committed to Ukraine and the lowest to Armenia and Azerbaijan (Graph 1). While it is difficult to present comparative data, according to rough calculations by EU delegations, it seems the aggregated budget operations annually constitute a significant part of the national budgets of Moldova, Georgia, and Armenia. For Ukraine and Azerbaijan, the support seems to be a minor contribution. In Moldova, it usually represents 4–5%, while in Ukraine it is around 0.1%. The average amount of each separate budget support operation was around €40–60 million for Ukraine, €20–60 million for Moldova, €15–30 million for Georgia, €10–20 million for Armenia, and €15 million for Azerbaijan. The duration of each programme was between three and six years, which means that a significant majority of operations have not yet been finalised. Therefore, the final level of absorption for a given country cannot be presented. However, the percentage of current disbursements hints that for Moldova and Georgia, the pace of implementation is the highest, while for others it appears problematic to spend the allocated resources (Graph 1). It is important, however, to note that the percentage of disbursement indicates the ease with which funds were allocated, not necessarily the progress of reforms. In terms of the accomplishment of a tranche's conditions, according to the EU delegation, Moldova ranks the highest (at almost 100%), with Georgia (90%) and Armenia (85%) close behind, while Ukraine (60–70%) and Azerbaijan (50%) lag.<sup>6</sup>

Indeed, EU budget support is conditional and the pace of fulfilling the indicators determines the payments of subsequent tranches. In detail, the system looks as follows. In order to agree on a concrete operation, the country has to fulfil the general conditions—it must have a national development/reform plan, a stable macroeconomic policy, a system of sound public financial management, and a published national budget.<sup>7</sup> In relation to general budget support, these conditions are all that is needed. For sector budget support, however, negotiations are held on a set of additional conditions and indicators of the relevant reform and are formulated into a so called policy matrix. This is an integral part of the financing agreement signed between the beneficiary and the European Commission. When the agreement is signed, the first fixed tranche is paid, then, according to the fulfilment of the criteria, further tranches are distributed.

Public financial management (PFM) and transparency are very important general conditions, as once the transfer of EU money has taken place, budget support funds will be used in accordance with the partner country's own PFM systems, and responsibility for the management of these transferred resources rests with the partner government. Therefore, fulfilment of this condition ensures that EU money is not used fraudulently and is spent to implement relevant policies, which includes transparency of the full national budget cycle, such as revenue administration, budget preparation, budget execution with cash management, procurement systems, internal controls and internal audits, accounting and reporting, and external audits and scrutiny. The European Commission checks only if the country has fulfilled the conditions, but does not pursue an audit of national accounts. Typically, monitoring involves annual EU evaluation missions consisting of external experts who screen the progress, supported by the conclusions of the EU delegation and

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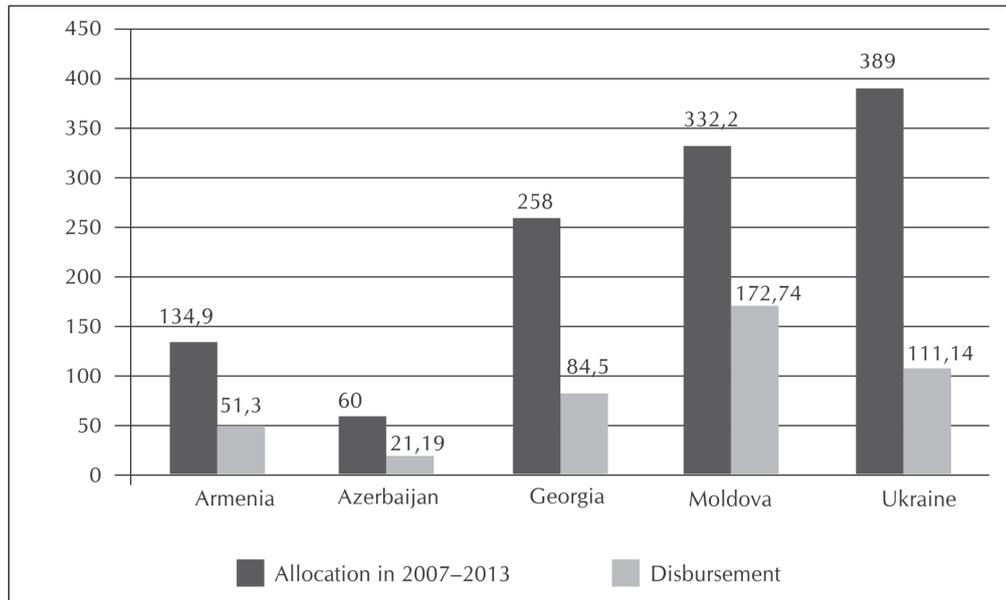
<sup>5</sup> The Arab Spring highlighted the EU's lack of means to support democratic transformation in its neighbourhood. In order to enhance democratic transformation in the neighbourhood, and as a consequence of the Arab Spring and review of European Neighbourhood Policy on 25 May 2011, the "more for more" principle was introduced.

<sup>6</sup> In the case of Ukraine and Azerbaijan, due to the problems with the fulfilment of the general condition on public financial management, the use of budget support was temporarily limited.

<sup>7</sup> The conditions are detailed in "Budget support guideline. Programming, design and management of budget support," the European Commission, September 2012, pp. 19–31.

budget support Steering Committees.<sup>8</sup> The EU also tries to increase the efficiency of budget support through ongoing capacity-building activities for the national public administration in the form of technical assistance, consisting of consultancy services by EU experts (usually from Member States).

**Graph 1. Budget support commitments and disbursements in 2007–2013 (in EUR millions)**



Note: For Georgia, the disbursement rate is relatively low as the country has been recently given an additional €49 million on the basis of the more-for-more rule. Moreover, €41 million more are going to be disbursed soon by the EU delegation. Source: The Polish Institute of International Affairs, 2013.

As budget support is a relatively new EU aid tool for third countries, it has undergone its first updates, as accepted in the Council Conclusions of 2012<sup>9</sup> that entered into force in 2013 with new guidelines. The major deficits of the system, which the EU tried to address, was insufficient transparency on the recipient side and the wide range of aid priorities.<sup>10</sup> The major changes planned to be implemented by the EC require:

- narrowing support to three priorities for each country,
- limiting the number of indicators to make reform more focused and achievable,
- introducing a condition that the national budget be published,
- increasing visibility and transparency by having the EU publish relevant information on budget support finance agreements, performance reviews (including disbursement conditions and assessments in agreement with the partner country); press releases regarding budget support payments and results achieved (and reasons for non- or only partial payment where applicable).

However, the researched operations in the years 2007–2013 in this report have been implemented according to the old rules as the EU delegations were in a transition period and discussing ways to implement the new guidelines.

<sup>8</sup> This body consists of EaP and EU officials discussing developments in budget support.

<sup>9</sup> Council Conclusions “The Future Approach to EU Budget Support to Third Countries,” Foreign Affairs Council, Brussels, 14 May 2012, [www.consilium.europa.eu/uedocs/cms\\_Data/docs/pressdata/EN/foraff/130241.pdf](http://www.consilium.europa.eu/uedocs/cms_Data/docs/pressdata/EN/foraff/130241.pdf).

<sup>10</sup> Court of Auditors Special Report No. 13/2010, *op. cit.*

## Moldova: Good Grades, but Could Try Harder

Anita Sobják

This section presents how budget support has been used in Moldova. In this country, several budget support programmes were launched in the years 2007–2013. Currently, there is one implemented operation in social assistance, five operations ongoing in the health, water, rural development, energy and justice sectors, and two new ones planned for launch on visa liberalisation and vocational education (Table 1).

The total amount of money planned for these eight operations (including the two newest ones still under preparation) is €332.2 million, of which some 52% has already been disbursed. Sector budget support has been the main EU assistance tool in Moldova, making up about 74% of the overall financial envelope proposed by the National Indicative Programme (NIP) for 2007–2010 (€209.7 million) and approximately half of the budget in the NIP for 2011–2013 (€273.14 million). Such a contribution looks particularly impressive if compared to the state budget of Moldova, of which it represents about 4–5% (the highest contribution among the EaP countries). Moldova has obtained additional resources under the “more for more” principle (€28 million).

The absorption rate has been increasing significantly over the years—particularly after the government change in 2009—just as the commitment of authorities to comply with the tasks assumed. This is well demonstrated by the exemplary absorption rates, with the exception of the programme for the water sector, which for already transferred tranches was close to 100%. Such a positive trend was interrupted by a several months-long political deadlock in the first half of 2013, which suspended reforms in process and postponed expected disbursements. Yet overall, budget support has been effectively fostering the undertaking of reforms in various sectors in Moldova.

**Table 1. Budget support operations in Moldova in 2007–2013**

Programme	Year	Planned financial resources (in EUR millions)	Disbursed amount (in EUR millions)*
Social Assistance (finalised)	2007	21	21
Health (ongoing)	2008	52.6 (6 under the more-for-more rule)	43.1; 6 (more-for-more rule) to be disbursed
Water (ongoing)	2009	50	27.03
Economic Stimulation in Rural Areas (ongoing)	2010	60 (14 under the more-for-more rule)	42; 14 (more-for-more rule) to be disbursed
Energy (ongoing)	2011	42.6	24.61
Justice (ongoing)	2012	60 (8 under the more-for-more rule)	15
Vocational Education and Training (planned)	2013	25	–
Visa Liberalisation Process (planned)	2013	21	–
		332.2 (304.2 + 28 under the more-for-more rule)	172.74

\* As of 15 October 2013 (disbursement source: <http://ncu.moldova.md/doc.php?l=ro&idc=423&id=1500&t=/BIBLIOTECA-ONLINE/Cooperarea-per-ansamblu/Asistentata-acordata-Republicii-Moldova-din-partea-Uniunii-Europene-actualizat-in-octombrie-2013>); data on disbursements are related only to budget support, not technical assistance. Source: The Polish Institute of International Affairs, 2013.

For Moldova, all external assistance—in that is budget support—is administered by the National Coordination Unit (NCU) within the State Chancellery. The direct implementation of operations is, in turn, in the hands of line ministries, with the help of technical assistance (TA) projects, which also participate in the internal monitoring of reforms. The line ministries coordinate with and present regular reports to the NCU on the progress in the implementation of the budget support conditions. Finally, the EU delegation is responsible for monitoring the implementation and evaluation, which is carried out on a yearly basis by independent evaluation missions. The disbursement of a subsequent tranche depends on the conclusions of the evaluation report.

This system allows for the generally smooth implementation of operations. The EU delegation perceives the Moldovan government as accessible (meaning not overly hierarchical) and receptive and as taking budget support seriously. No major hurdles have been recorded in the implementation process thus far, and in this Moldova excels beyond all other recipient countries in budget support. Still, problems occur from time to time on both the EU's and beneficiaries' sides. The former can be late, for instance, in preparing evaluation reports, the latter in delivering results, in which case the EU either extends the deadline or provides less money than expected, proportional to the targets achieved.

Subject to criticism, however, is the monitoring and evaluation portion. Since the EU delegation oversees this part in its entirety, mechanisms should be developed for independent monitoring carried out by the ministries and civil society actors. Also, as by now the national authorities have already gained sufficient understanding of the budget support cycle, they should be more included in the EU delegation's joint monitoring and evaluation process.

### The Role of Budget Support in Funding Reforms, and Major Challenges

Conditionality is generally successful in making politicians more responsible in delivering on their commitments. According to the EU delegation, the EC is stricter with Moldova than with other states in the region because the amount of budget support from the EU makes up a particularly large part of the country's budget. As such, the process of setting conditions is strict, while at the same time allowing for some flexibility at the programming phase (the government can request amendments).

In terms of general conditions, Moldova has no major problems related to fulfilment. A good example of this is the requirement to have appropriate legislation on public financial management, one of the most important general conditions for budget support. In Moldova the PFM mechanism in place at the end of 2012 met expectations. Despite a delay caused by the aforementioned political crisis in 2013, the new Strategy for the Development of the Management of Public Finances 2013–2020 was finally adopted.

However, in terms of sector-specific conditions there are concerns related to some grade of superficiality in their application: while most targets are achieved on paper, which gives high absorption rates, in some cases there is no time, political will or social demand for the reforms to be carried out thoroughly. As such, many of the reforms deliver the legislative changes required by the EU, yet are only half-heartedly entered into force and have little impact on society. This points to a serious need on the EU's side to go beyond demanding legislative approximation, and to improve the system and push for actual completion of the reforms. In technical terms, this would also mean ensuring that each planned activity should be allocated sufficient funds for its completion and should be written down in the policy matrix<sup>1</sup> (it happens that some objectives are

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<sup>1</sup> A policy matrix is part of the financial agreement between the EU and the recipient country and includes precise information about the conditions and terms of fulfilment.

unrealistic to achieve or that some others, i.e., legislation, could be delivered without any financial assistance). One area that can serve as a model here is the policy matrix for the programme for the energy sector: it is very accurate and measurable, setting a percentage link between the specific targets achieved and the amount of corresponding tranche to be transferred.

A further aspect that should be awarded more attention in the planning period, is a thorough assessment of the feasibility and financial implications of the required reforms. If to look at the long-term economic effects of budget support—and bearing in mind the experience of pre-accession funds in Central European countries—the concern is that this sort of financial assistance might contribute to macro-economic destabilisation. The reform commitments undertaken in the financing agreements signed with the EC imply huge investments, only part of which are covered by budget support itself. According to the recipient and experts, for a country with very limited own-resources like Moldova, such reforms are often too ambitious (e.g., environmental requirements). Unfortunately, no analysis has been conducted on how much it would actually cost the Moldovan government, and the gap will often have to be covered from external loans (general budget support serves as good leverage for loans from international financial institutions). In the long run, this might leave Moldova considerably in debt.

Whereas conditionality is seen as a relatively efficient tool of pressure, this is not the case with the principle of “more for more,” which the majority of respondents (recipients and experts) considers to be absent of any substance in the context of budget support. The major problem with this is that there is no concrete criteria as to what constitutes “more” reforms and “more” incentives. As there are no set targets for the spending of additional funds, they are inconsistent with the policy matrix, and national budget expenditures on concrete reform and the use of “more for more” is not at all accountable. Besides, some experts suggest if there is “more for more,” there should also be “less for less,” according to sticks and carrots analogy.

The major hindrance to the quality of the implementation mentioned by almost all of the respondents is the fact that TA usually starts one or one and a half years after the onset of the programme itself (because it requires a tender). The overall role of TA is to provide support and advice to line ministries on the fulfilment of targets and indicators agreed with the EC. Since this implies training activities, the respondents recommend that TA start six months before the launch of the operation and last at least six months after its conclusion. In terms of efficiency, TA varies depending on the sector, but its quality was generally deemed satisfactory (particularly in the energy and health sectors).

While TA is meant to ensure specific knowledge of budget support, there is also a more general problem of the poor capacity of the administration staff, which presents a challenge to the efficiency of implementation. This problem manifests itself in the lack of skills to fulfil the budget support obligation as well as in some systemic problems. This lack of skills is a result not only of insufficient on-the-job training but also of the low levels of motivation to embark on a career in public administration. This is understandable given the low wages in the public sector,<sup>2</sup> which is also the cause of the rapid turnover of personnel. More importantly, inter-ministerial communication and coordination is not sufficiently developed, which hampers implementation of the required reforms. The line ministries also often lag the Ministry of Finance in terms of understanding and the level of information on budget support. These problems are hard to address through TA, as the solution lies in the Moldovan government’s reform of its public administration system.

With respect to transparency in the budget support cycle and in spite of having relevant legislation in place, some stages are still quite opaque. In the programming phase, for instance,

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<sup>2</sup> In Moldova, the minimum wage in the private sector is €81, while in the public sector it is €52.

civil society has no insight, while information is scarce even in the line ministries. Throughout implementation there is already more information available on budget support through donor meetings, public consultations and information sessions organised by the NCU. The ministries' websites publish basic information on the operations, yet these are sometimes difficult to find and do not contain elements essential for real accountability, such as the policy matrix or the evaluation reports. Currently, the NCU is working on a database, the External Aid Management Platform, which will aim to make external assistance more visible.

The greatest challenge of visibility of budget support is that the money is transferred to the state budget without any marker that it comes from the EU. Still, there are some efforts being made to increase the visibility of this type of financial assistance from the EU. For instance, already at the end of the programming period the financing agreement is signed in the framework of a large public event, usually with the participation of the prime minister. Also, the disbursement of every tranche is marked by press releases, conferences and sometimes the head of the EU delegation and line minister jointly present the results of the given operation.

The shortcomings in transparency and visibility are among the reasons for the low level of engagement of civil society in budget support programmes, yet they are not exhaustive. According to the recipient, another hindrance lies in the capacities of civil society actors to provide a quality contribution to devising and implementing reforms. Given that the current political elite and central administration staff in Moldova have largely grown out of civil activist circles, the basic channels for an exchange of views are given. Yet, this also implies that civil society needs a new generation that can serve its policy-shaping role. Also, civil society in Moldova is perceived by the respondents as being still weak in that it consists of sporadic organisations with social backing. It is also true that interest on the part of civil society depends on the topic: while some issues present wider social concern (such as energy efficiency of buildings, which is one target of budget support in the energy sector), others are largely technical and less attractive for a wider debate.

At the same time, the government does not actively reach out to civil society. Public consultations are often only *pro forma* and the government does actually little to genuinely involve the public in the whole process. The public's role is also minimal in the programming phase of the discussions, which take place primarily among the EC, the EU delegation and the government. It is only when the technical *fiche* is prepared that external consultants are commissioned and obliged to seek the opinion of civil society. Yet these are only technical details and do not ensure society's desirability of the priorities themselves. With respect to monitoring and evaluation, civil society is again consulted by external experts from the evaluation missions, but no independent evaluation is carried out by civil society itself. This will change in the 2014-2020 budget period when separate funding will be allocated for monitoring purposes. Providing a dedicated line of funding might not be enough in order to strengthen the engagement of civil society. The EU should insist that the Moldovan government improve conditions for CSO development in terms of the legislative environment and financing schemes.

## Conclusion and Country-Specific Recommendations

Overall, as the absorption rates and generally good record of implementation demonstrate, Moldova stands out among the recipient states in terms of its dedication to implementing reforms with EU budget support. The Moldovan case is also particular in that budget support allocations make up a significant part of the state budget, which is telling about the state's dire economic conditions (in comparison with other recipients, such as Ukraine or Azerbaijan). Therefore, whether merit-based or need-based, it is advisable to further increase budget support allocations for Moldova. At the same time, it is necessary to improve the design of the budget support operations. Conditionality should become more realistic, accurate and measurable, for example,

in the policy matrix used by the programme in the energy sector. Moreover, the policy matrices should be more flexible in the future, allowing for on-the-run updates of conditions in line with actual developments. To accomplish this, at the end of each calendar year independent experts from the evaluation missions should formulate recommendations for targets for the next year of budget support.

With respect to institutional capacity, the current knowledge gap between the line ministries and the Ministry of Finance should be levelled by providing training for the line ministries in such areas as budget management and project cycle management. Upon the transfer of monitoring skills by the TA team to the ministries, a national evaluation system should be established for all operations and involve civil society.

Finally, in order to go beyond just demanding legislative approximation and devote attention to actual implementation of reforms, it is necessary to increase the social acceptability and desirability of these changes. One means to legitimise the reforms would be the more active involvement of civil society representatives in all phases of the operations. The transparency of the entire process should also be improved by, for example, making the policy matrices and evaluation reports publicly available.



## Georgia: A Bright Spark Struggling with the Homework

Elżbieta Kaca

This section presents how budget support has been spent in Georgia. Budget support expenditures amounted to €258 million in 2007–2013 and made up 60% of Georgia’s national budget. This sum consisted of €216 million planned for budget support, including €49 million allocated under the “more for more” rule to some operations and the rest for technical assistance and other grants (Table 1). In this period of time, 12 programmes were planned, out of which two projects were finalised, six are still under implementation, and four are in the planning process. The majority of the financial resources have been disbursed, as the level of EU conditions met for each tranche hovered around 90%. The EU de-committed only €2.5 million as Georgia had not fulfilled some EU conditions due to changes in the government’s political priorities.

**Table 1. Budget support operations in Georgia in 2007–2013**

Budget support operation	Year	Planned financial resources (in EUR millions)	Disbursed amount (in EUR millions)
Public Financial Management	2007–2010	16	12.4
Criminal Justice Reform	2008–2011	16	14
Vocational Education and Training reform	2009–2012	19	16.1
Public Financial Management reform	2010–2013	11	6; 3 to be allocated
Regional Development reform	2010–2013	19	10; 7 to be allocated
Conflict Affected/Displaced Population and Host Communities	2011–2014	19	10; 7 to be allocated
Criminal Justice Reform	2011–2014	24 (including 6 under the more-for-more rule)	10; 12 to be allocated
Agricultural Development	2012–2015	40	6; 2 to be allocated
Regional Development reform (financial agreement to be signed)	2013–2016	30	–
Public Financial Management reform (financial agreement to be signed)	2013–2016	21	–
Border Management and Migration	2012	16 (more-for-more rule)	–
Vocational Education and Training, and Employment	2013	27 (more-for-more rule)	–
Total		258 (including 27 for technical assistance; 15 for grants; 49 more-for-more rule)	84.5 (plus 41 to be allocated)

Source: The Polish Institute of International Affairs, 2013.

The budget support aid is coordinated by two institutions: the Programme Administration Office (PAO) of the Office of the State Minister of Georgia on European and Euro-Atlantic Integration (OSMEI), which is responsible for EU funds, and the Ministry of Finance (MF), which is in charge of all international assistance. The involvement of PAO in budget support is more important in terms of planning and programming, while the Ministry of Finance is crucial for implementation. The role of this body is to elaborate in cooperation with the EC (through the EU delegation to Georgia<sup>1</sup>) the joint vision regarding the priority sectors to be supported by the EU. In the implementation phase, this office's role is limited to advising the ministries/agencies to develop proposals, to submit requests, to choose the type of assistance, etc. Moreover, it coordinates the work of the Governmental Commission on European Integration, involving all line ministries, and is headed by the prime minister. The Ministry of Finance is a major player in implementation and a crucial contact point for the EU delegation. The financial resources are not redistributed to line ministries responsible for fulfilling the conditions agreed with the EU but go to the national budget. The MF manages the national budget and in this way it has leverage over the other ministries to make them comply with the EU conditions. The overall amount of budget support operations comprises 0.4–1.2% of the national budget annually, and this money can be spent, for instance, to decrease the deficit in public finances, which makes the Ministry eager to cooperate with the EU.

The EU fears that decentralisation of the system—if programmes were to be negotiated separately with each ministry and financial resources transferred directly to their accounts—would not attract engagement (the average operation amount is as much as around €20 million). By and large, Georgia's system fits into the budget support concept: money goes to the national budget and the EU checks if the country fulfils the agreed reforms.

The other characteristic is that the coordination system suffers to some extent from a communication deficit between PAO and the Ministry of Finance, as the latter is not always fully aware of the EU objectives, while the Programme Administration Office is not always consulted properly about the implementation.

### The Role of Budget Support in Funding Reforms, and Major Challenges

The use of budget support in Georgia is assessed by both sides as satisfactory. Despite the high level of indicators of accomplishment, several challenges have arisen in terms of implementation. The political will at the level of concrete ministers varies in each case. While for the Ministry of Finance and Ministry of Justice there was much engagement, in some other cases the process was much slower (for instance, the problems met in regional development and VET). There are several reasons for this.

First, even though the EU delegation is praised for having a good understanding of the country's situation and chosen priorities are assessed as relevant, one problem is that the EU cannot seem to choose the right spectrum of sectors. For the recipient, this limits its choices. It seems that the EU sometimes tends to push for reform methods based on Western experiences that are not always suitable to Georgian situation. This results in difficulties gaining political backing for the reforms. The best example of this is the misunderstanding on how reform of regional development should be performed: the EU has tried to push for a decentralisation of competences based on EU experiences (with other donors such as GTZ, UNDP, Polish Aid) while the Georgian government has perceived this reform to have resulted in an increase in expenditures in sector policies in the regions. At the end of the day, Georgia drafted a national regional development

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<sup>1</sup> For the EU delegation, each budget support operation is covered by a policy manager (eight people), plus management and some ad hoc contracted personnel.

strategy together with regional strategies as required by the budget support conditions, but the system remained centralised.

A second challenge is that conditions and indicators are not always formulated clearly. The interviews confirmed that some of these were vaguely phrased and only in some cases were they corrected by the Georgian administration, depending on the capacity of the ministry. This hampers implementation, as the recipient does not have clear indications of what steps should be undertaken.

Third, according to some Georgian ministries, the ability to modify the conditions when the political situation changes is very low. This makes it difficult to change the preconditions once the financial agreement is signed, even though in some cases updates have been made, i.e., to justice and vocational education. This creates the risk that some of the conditions will remain outdated due to switches in political priorities.

Fourth, the line ministries do not receive additional resources for reforms and feel discouraged to fully engage in implementation, and they do not understand clearly the budget support idea. Only in some cases have they received additional resources, mainly when the EU included in some financial agreements a condition that the budget for concrete reform must be increased by 5%. Numerous experts and Georgian officials note that this situation results in a huge gap between the activities to be performed by Georgia under the agreements and EU money for that purpose. Obviously the EU cannot fully finance the reforms, but a down-to-earth cost estimation would help in the planning and implementation stages. In practice, however, both sides avoid such calculations of a particular reform covered by EU assistance, but for different reasons. The Georgian administration simply still does not have an efficient system for such cost estimations, while the EU knows it offers too little money for the claimed activities. It seems the EU expects the government to foot the rest of the bill or for another donor to step in.

Best practices have already been employed by the EU delegation to address the two deficits mentioned above in agriculture sector reform. A wide consultation process was launched. The reform possibilities were discussed not only with the government but also with parliamentarians, businesses including small and medium-sized enterprises (SME), civil society organisations (CSOs) and other donors. Moreover, budget support was enriched by other aid tools, such as grants for non-government stakeholders, communication activities and international organisations. This solution led to the increased ownership of the crucial parts into the budget support programme and enabled the drafting of realistic conditions.

In terms of technicalities, the process seems to be EU-imposed and too lengthy. The EU is blamed by recipient for having too bureaucratic a programming period. While the process of identifying the priority directions is very smooth (no more than two months), the main delays usually occur when drafting the relevant financing agreements, including the conditions and timetable for accomplishment (so called policy matrix). The Georgian side usually spends two or three months elaborating strategic directions in the relevant sector, while the EC needs nearly seven months for internal consultations.

According to the EU delegation, a less important factor in implementing budget support in Georgia seems to be the absorption capacity of the national administration. By and large, the Georgian administration is assessed by the EU delegation as efficient in terms of fulfilling the requested requirements. Since 2007, due to the high turnover of staff within recipient administrations, some institutional memory has been lost, but in the years 2010–2013 the fluctuation of officials working on budget support projects has decreased and the country has gradually learned how to implement sector budget support.

Problems are related more to general public administration system deficits. First, the recipient institutions sometimes lack competent staff to deal with all of the assigned questions

and feel the necessity to outsource some work. The ministries are simply overburdened with organisational work and therefore lack political intelligence units that would enable substantive reporting and proposing of inputs in the programming. Second, often the knowledge of English among the national officials is not sufficient. Last but not least, some programmes have been hampered by weak coordination among various institutions (e.g., criminal justice, VET) and high officials turnover.

The EU tries to address these challenges through TA, which is perceived by the Georgian side as helpful in preparing them to implement programmes: the system is assessed as clear, aligned to its needs and inclusive in all steps, starting from choosing specific spheres, through implementation, working on expert criteria, etc. What is important is the positive evolution of the system has been noticed: currently, the ministries more actively participate in the process of the selection of experts so as to limit miscalculations. In some cases, the quality of the TA expert assistance was not high enough (e.g., in justice operations). Still, however, the system is dominated by foreign experts with few nationals.

According to the recipient, another drawback is that TA usually starts too late, after budget support is launched, and in this respect is not yet flexible enough. The delay is caused by lengthy procedures, therefore the assistance is not available when it is the most needed, in the programming period.

The transparency of budget support in Georgia might be perceived as an example for other EaP countries. Indeed, due to the relatively transparent system of PFM, the monitoring of public expenditures is not troublesome.<sup>2</sup> There is ongoing cooperation with the EU on improving PFM, namely internal auditing. Moreover, information about most projects is put on the websites of the respective ministries, though detailed conditions and the policy matrix are published on a case-by-case basis. The Georgian administration also employs several best practices in involving civil society. CSOs can participate in some advisory bodies, e.g., in a PFM coordination council or local regional councils established by the Ministry of Justice. What is important is that in some cases the EU puts particular conditions into financing agreements on enhancing civil society engagement into policy dialogue. For instance, one of the conditions in VET reform was the launch of consultation with trade unions, and in regional development, the creation of regional councils with the involvement of CSOs. In addition, the EU organises informative meetings with the EU delegation and finances CSO monitoring activities: some Civil Society Facility grants were released for CSOs to monitor PFM developments. A serious challenge is the weakness of civil society in Georgia, and therefore the lack of organisations interested in monitoring government cooperation with the EU. Added to that the low public interest in EU actions and the visibility of budget support is hard to sustain. Although in some cases TA had public relations elements, such as media coverage, conducting surveys or implementation of awareness campaigns, the impact on the population is rather low. The opportunity for communication activities usually arises when the government announces some actions in the reform field.

## Conclusion and Country-Specific Recommendations

In general, budget support assistance is aligned with the national priorities in Georgia, as assessed by both sides. More EU work should be done, however, to coordinate this aid with various donors active in the country. On the Georgia side, namely the cooperation between PAO and the Ministry of Finance should be improved in terms of information flow. In order to help

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<sup>2</sup> Public Expenditure and Financial Accountability was done 25 June 2013. This is the World Bank methodology of assessing public financial management for a given country.

Georgia prioritise its reform activities a high advisory mission consisting of high-level experts could be launched (similar to Moldova).

Budget support implementation in Georgia proceeds rather smoothly, but the results in the accomplishment of the supported reforms vary case by case. While the Georgian government seems to be engaged in cooperation with the EU, the recipient administration in some cases lacked consistent and permanent political support to achieve the reforms foreseen by the agreements. This was the result mainly, on the one hand, of the ministers' personal preferences and low administration capacity of some of the ministries, and, on the other, of the fact that the ministries were not obtaining additional budget resources, EU conditions were not precise enough, and relevant reforms were not properly assessed in terms of their costs. Therefore, more work should be done to provide more incentives to the government to perform EU-supported reforms. First, the planned operation should be consulted with various stakeholders such as parliamentarians, CSOs and other interest groups. This would enable working out more realistic conditions. It is advisable to enrich budget support through various other EU aid tools in order to diversify the activities and reach different groups, not only the government. Second, in order to increase the engagement of relevant line ministries, the threshold for allocating financial resources to a concrete ministry should be increased by more than 5%. Moreover, the EU should help Georgia assess the costs of relevant reforms and, accordingly, propose financial support to sustain the link between the money and activities.

At the technical level, the budget support assistance system has low capacity to rapidly react to political changes. From the EU side, it would be rather expedient to have more simplified and less time-consuming procedures for drafting and agreeing relevant financing agreements and policy matrices. In order to increase flexibility, the revision should be made between payments of tranches—a mid-term review between the second and third tranches should be conducted in order to assess if the conditions are still relevant. Another issue is to build on the Georgian administration's absorption capacity using TA. In future programmes, more efforts should be made to develop interministerial cooperation, launch the assistance before the operations start, target the administration with training on procedures and the concept of budget support, hire more local experts, and invest into improving the Georgian language skills of the EU delegation.

In terms of transparency, Georgia can serve to some extent as the source of best practices in terms of PFM and CSO involvement, namely the practices to include CSOs in steering committees and in putting some EU conditions on involving CSOs in a policy dialogue with the government, and disbursing EU funding for monitoring. As the limit of CSO involvement is tied to the weakness of this sector, the EU should push more for creating a favourable legal environment for CSO development in Georgia. On sustaining transparency, there is still room to manoeuvre to improve performance on audits of national expenditures, in creating better monitoring mechanisms at the Georgian national level, and in publishing all policy matrices on ministry websites. In relation to visibility, the EU should cooperate more with the Georgian government and support its communication plans related to EU affairs. The momentum of the signature of the AA should be used to communicate to people the types of rights and obligations for Georgia in aligning with EU standards.



## Ukraine: Too Big for School

Elżbieta Kaca

This section presents how budget support has been used in Ukraine. Sector Budget Support (SBS) is the predominant EU assistance tool in Ukraine, with around 60% of all EU aid to the country planned to be spent in this way in the years 2007–2013. Six agreements were signed in the sectors of energy, energy efficiency, trade facilitation, environment, transport, and border management, and another is awaited in energy for an overall sum of €389 million (Table 1). However, in total Ukraine received payments of no more than one third of this amount (€111.14 million) because since 2011 the EC has limited transfers for all operations. The main reason for this was non-fulfilment of a precondition on PFM, as since 2011 the country's public procurement law and budgetary transparency have significantly deteriorated.<sup>1</sup> This crucial condition ensures that funds are not fraudulently used. After two years of futile discussion on the implementation of this condition, the Ukrainian government finally adopted a PFM strategy in September 2013 (not made public) as this issue was made an EU condition to sign an AA. However, the reform on PFM stalled and Ukraine's parliament has failed to reverse amendments to the law on public procurement passed in 2012, criticised by the EU as a source of corrupt procurement schemes. As a consequence, the decision to unblock the tranches is still under discussion by the EU. However, this two-year rupture has made line ministries demotivated to continue with this type of aid: they had to fulfil the agreements but have not received financial resources for the delivered activities. At the same time, they had no impact on the government to implement relevant changes in PFM to unblock the aid.

**Table 1. Budget support operations in Ukraine in 2007–2013**

Programme	Planned financial resources (in EUR millions)	Disbursed amount (in EUR millions)
Energy	82	68.14
Energy Efficiency	63	31
Removing barriers to trade	39	12
Environment	35	–
Transport	65	–
Border Management	60	–
Energy (to be signed)	45	
Total	389	111.14

Source: The Polish Institute of International Affairs, 2013.

Despite the problems related to the PFM condition's fulfilment, the Ukrainian administration perceives budget support positively as a sign of trust from the EU side. In fact, this tool does not need any intermediaries and contrarily to TA, it allows it to purchase more goods and services. In

<sup>1</sup> "Ukraine took only at a late stage initial measures to start removing the EU's concerns related to public financial management. This led to delays in planned disbursements under EU sectoral budget support." Implementation of the European Neighbourhood Policy in Ukraine Progress in 2012 and recommendations for action, Brussels, 20 March 2013, SWD(2013) 84 final, p. 2.

terms of institutional solutions, the Ministry of Economic Development and Trade and the Ministry of Finance play major roles in coordinating budget support in Ukraine. The first is the main coordinator responsible for managing the system, analysing the general situation and reporting to the government, while the latter requests disbursements from the EU.

In the current system, the EU as well as Ukrainian administration find it difficult to efficiently control the achievement of the required indicators, as there is no effective monitoring mechanism at the level of the Ukrainian line ministries to gather data from the institutions involved in budget support. Moreover, the monitoring committees cannot execute any action from other institutions.

Another characteristic part of the Ukrainian system is that budget support financial resources are not transferred to the national budget but to special state funds that gathers international assistance, then from there the funds are distributed to line ministries.<sup>2</sup> The question is, however, whether the ministries get the expected money, as the transparency and efficiency of the functioning of the state funds has been challenged. Due to lengthy and restrictive procedures, the ministries obtain the tranches with huge delays, and only for some types of expenditures. One factor hampering this process is the ministries' lack of will and capacity to complete the procedures.

Still, after seven years of existence, the system is characterised by a misunderstanding of the budget support concept between the EU and Ukrainian officials. In fact, the latter perceives EU money as an option to finance some equipment or some activities, and requests a relevant amount of financial resources. For instance, the Ministry of Environment has foreseen specific activities to be covered by funds in its national environment strategy. The ministries also usually start planning expenditures when they receive the money. This could result in a generally difficult budget situation for the ministries if the EU funds replace, rather than complement, national funding. Conversely, for the EU, such a "project" approach goes against the logic of budget support, as this aid tool aims to help with already ongoing reforms.

### The Role of Budget Support in Funding Reforms, and Major Challenges

Experience with budget support use shows that it helps the legal approximation to EU standards in different sectors while it fails to support the implementation of required legislation. Usually, the Ukrainian administration feels at ease in drafting any strategies and adopting some part of the legislation required by the agreements: usually it fulfils 60-70% of the indicators of the agreements. This makes budget support, based on results, a more efficient tool for the EU than other advisory instruments in the scope of TA, due to the use of conditionality. In fact, according to the respondents, budget support operations fail to support the implementation of legislation. The best example is trade facilitation, which began in 2007, and where the required legislation has been adopted but the process of implementation, meaning relevant actions undertaken by the government to have the reform enter into force, is very slow. There are numerous reasons to explain the failure of budget support in terms of impacting the implementation stage of the reforms.

The first factor is whether the Ukrainian government has the political will to proceed in the direction of the EU-oriented reforms. As the research shows, in numerous budget support operations, both sides—the Ukrainian officials and the EU delegation—complained about the lack of political will at a higher level to push for relevant reforms. This made any EU attempt to

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<sup>2</sup> The Ukrainian state budget consists of general and special funds. The budget code defines which revenues go to which funds and for what purposes. The procedures for both types of funds are almost the same.

agree with Ukraine on good governance reforms doomed to fail. The best example of this is the inability of the Ukrainian government to effectively use budget support of €70 million for public administration reform. The picture, however, is not so black and white—some ministries at the middle-management level were engaged in the process and ready for changes. For them, the agreements with the EU are the reference point for any changes to push for. Due to government unwillingness for reform, they have no leverage to undertake the actions. The strict hierarchy of ministries hinders the implementation process, as without a directive from the political level, nothing happens.

Second, the possible weight of budget support in terms of attracting political interest is also limited by the fact Ukraine is a large country with a much bigger budget when compared to other EaP states, and therefore the volume of assistance needed is higher.<sup>3</sup> In fact, budget support constitutes only a minor part of the annual Ukrainian national budget: on average 0.1% annually.

Third, the problem is that budget support operations lasting at least three years are at risk because of changing political priorities, not only due to elections but also because of top level changes. The government is very weak at following a multiannual strategy/action plan. The trade and energy efficiency sectors were hampered by administrative reforms due to presidential elections in 2010, while in the transport sector the conditions were outdated, as by the start of the SBS project the agreed priorities had been achieved by and large.

Last but not least, implementation is hampered by the scope of EU conditionality. According to the recipients and experts interviewed, the EU tries to support too many areas in a particular sector and the conditions are sometimes too ambitious and too broadly formulated, and thus simply unrealistic. For example, some legislation required in the environmental sector is even difficult to adopt in the EU Member States, and too broadly formulated conditions for energy efficiency cannot be met. To some extent, the explanation for this lies in the fact that in the first operations each side lacked the relevant experience in the proper formulation of conditions and independent experts to peer-review the indicators were rarely hired. Although the recipient confirms full involvement in the process of drafting the conditions, it seems that its low capacity in terms of policy analysis hampered proper reaction to EU proposals. The recipients and experts therefore call for narrowing the areas of budget support operations and focusing only on some parts of the strategies, supporting more its implementation phase and making the conditions as precise as possible. In fact, it would serve to increase conditionality. Currently, the EU, by setting objectives vaguely (not operationally) and trying to cover too many areas, achieves limited conditionality.

Taking into account these shortcomings, the question arises whether the budget support sectors chosen in Ukraine are the best in terms of potential EU impact. Ukrainian officials confirm that the areas chosen are of crucial importance for Ukraine's development. The beneficiaries rarely ask the EU to provide budget support in a specific sector, which means that the EU suggests the priorities to choose from. The query is whether the choices made are optimal in terms of meeting the EU's interest. For instance, the supported areas of energy and energy efficiency are challenging for reform due to various oligarchs' interests and the huge amount of financial resources needed to cover the achievement of the national strategy (amounting up to €100 billion, according to a Ukrainian government estimation, which might be exaggerated, while the obtained EU budget support was €68 million). Therefore, whenever there is no political will to commit to huge reforms it might be better to focus on more narrowed policy areas or other sectors where the results can be demonstrated more easily and where the EU has direct interest (border management) rather than

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<sup>3</sup> According to the IMF, in 2012 Ukraine was 106<sup>th</sup> in terms of its GDP per capita (out of 187 countries). Azerbaijan was 88<sup>th</sup>, Armenia was 118<sup>th</sup>, Georgia was 119<sup>th</sup>, and Moldova was 137<sup>th</sup>; available at [www.imf.org/external/pubs/ft/weo/2013/02/weodata/weorept.aspx](http://www.imf.org/external/pubs/ft/weo/2013/02/weodata/weorept.aspx).

some strategic areas (energy security) where no substantial progress is possible through budget support. For instance, in border management, which is part of the EU conditionality related to obtaining a visa-free regime, EU budget support covered almost 20% of the costs. Such an approach risks, however, that the EU will deal with technical and secondary policy areas from the point of view of EU interests.

Beside questions related to the conceptual framework of budget support, technicalities must be revised as well. On both sides there are gaps to be addressed. EU budget support rules are perceived as too bureaucratic, inflexible and lengthy, while on the recipient side the biggest problem is the inefficient public administration system (Table 2). The “bureaucratic” character of EU support is derived chiefly from the EU’s caution with regard to corruption and mismanagement of funds. The source of the problem with public administration efficiency is the inheritance of a system from Soviet times.

**Table 2. Major implementation barriers as perceived by the EU and Ukraine**

The Ukrainian administration	The EU
<ul style="list-style-type: none"> <li>– the duration of programming, which can last up to two years;</li> <li>– inflexibility of the EU in terms of changing the financial agreement and conditions;</li> <li>– the insufficient amount of training on general and specific procedures of budget support;</li> <li>– the lack of frequent communication on budget support from the EU delegation, depending on the sector.</li> </ul>	inefficient public administration system consisting of: <ul style="list-style-type: none"> <li>– a high level of corruption;</li> <li>– inefficiency of management;</li> <li>– the fear of officials to take decisions;</li> <li>– the responsibility of management that is not in the state interest;</li> <li>– lack of policy-oriented administration units.</li> </ul>

Source: The Polish Institute of International Affairs, 2013.

TA that aims to help the national administration with budget support implementation still lags in addressing the majority of these gaps. By and large, this tool is perceived as useful, but it needs some obligatory improvements. First, as acknowledged by all parties, it is fundamental to commission TA prior to the budget support negotiations in order to involve external experts in the process of programming and indicator drafting and to last for the whole cycle. Currently, ordering TA foreseen in the financial agreements can take up to a year after the operation starts. Second, according to some interviewees, the weak expertise of the EU experts, who unable to offer realistic recommendations, hampers TA. The criticised expertise areas included border management and environment. A third problem to address is to not use TA to replace the duties of officials (i.e., drafting monitoring reports that should be delivered by the national administration) as this limits building the analytical capacities of the administration. The underlying problem is that in order to acquire relevant skills, the beneficiary administration needs more long-term programmes (i.e., of 5–10 years).

Last but not least, a weak point is in the transparency and visibility of budget support operations to civil society. Even though in 2013 the condition on transparency has entered into force, there are no concrete plans for how to implement it in practice. Ukrainian officials treat EU guidelines as non-obligatory. In most cases, representatives of NGOs are not invited to the monitoring sessions and have limited access to information. The only exception was in environmental budget support where NGOs participated in a joint monitoring committee and their involvement was supported by TA. Although NGOs have the right to receive information by simply sending in a request to the national administration, in numerous cases the Ukrainian officials refused such requests. This makes the EU delegation also reluctant to release any detailed information about implementation in order not to hamper its cooperation with the government, as the EU operates on the basis of mutually agreed release of information. There also are arguments

to not involve NGOs in the monitoring, such as the fear that government related organisations (so called GONGOs) or that NGOs representing other lobbying groups would appear (especially in energy) or that there is a lack of NGOs in particular sectors. Therefore, a better solution would be for the EU delegation to finance independent NGO monitoring of national strategy implementation in relevant sectors and to support the involvement of NGOs in official consultation mechanisms with the government. In terms of increasing visibility, the problem is, however, how to capture media and social attention, as budget support is too abstract for most people. Although the EU delegation made public the fact that the Ukrainian government rejected €70 million for public administration reform, there was not much media interest in it. However, best practices were followed in transport budget support, where part of this operation financed a public campaign on road safety as part of Ukraine's approximation to EU standards.

## Conclusion and Country-Specific Recommendations

The general assessment whether budget support is an effective instrument in terms of bringing the results of agreed reforms in Ukraine varies. On the one hand, the use of this assistance tool in Ukraine is challenged due to problems with PFM and a lack of real commitment to reforms. On the other hand, it seems that this instrument is successful in terms of legislative approximation with the EU.

The main issue to solve is how to make the Ukrainian government reform PFM, which would enable further budget support. The EU should not discuss any new budget support operations with the Ukrainian government unless it takes serious steps to implement its new PFM strategy. Coherent conditionality should be kept in this respect. Still, the challenge is to enhance the implementation of the required legislation. It seems that the new government chosen in March 2014 is determined to pursue reforms in the EU direction and sign a DCFTA deal as soon as possible. The EU could find therefore areas to be covered by budget support but it must be narrowed and the conditions made more realistic to obtain the funds. If the EU wants to enhance comprehensive reforms, it must ensure coordination with international financial institutions and gather significant funding. This process of discussing reforms also requires lots of communication with the ministries by the EU delegation to explain the system of aid. Due to the high turnover of staff at the high political level, it would be advisable to introduce some flexibility in terms of changing conditions after the agreement has been signed. Given the quite unstable political environment at the moment, there should be a mechanism enabling the EU to adjust financing to the new needs so as to react flexibly to the situation. The challenge is to upgrade the supported activities to a higher political level—this might be obtained by the involvement of all of the crucial parties in joint monitoring committees. Any problems related to its budget support performance should be made public. This is related to increasing the transparency and visibility of the implementation of budget support. Taking into account the particular institutional solution in Ukraine and the fact that budget support money is disbursed by state funds, it would be advisable to finance watchdogs that could monitor activities on PFM with a particular focus on the functioning of such funds. In this respect, civil society oversight is needed not only in formal compliance with regulations (this is a smaller problem) but more importantly of the impact of funds on the implementation of required reforms—whether funds reach the final recipients, whether society is aware of the available funds, to what extent the decision-making is participatory.

Other steps should also be taken. The policy matrix should be translated into reader-friendly language and published on the EU delegation's website. Moreover, regular press releases on programme fulfilment should be sent out to a wide audience. Sector NGOs should participate in joint monitoring committees. If there is a problem with NGO selection, a consultation should be launched with the Ukrainian platform EaP Civil Society Forum. Positive steps to be taken by the

EU delegation would be to schedule funding for NGOs to monitor the national strategies. More efforts must be made to increase the general visibility of budget support and promoting its results in media. The best practices to date in the transport sector should be continued (e.g., the road safety campaign), with promotion around wider issues related to required legislation.

At the technical level, numerous changes are required. As one of the major gaps is the weak efficiency of the Ukrainian administration system, the EU should reshape TA. First, it should assist all cycles of budget support, but in particular the programming and drafting conditions phases. Second, TA should be varied: assistance in programming and prefeasibility studies, building up the capacity of the national administration, and work on the visibility of operations. Third, in terms of capacity-building, a good solution would be to support some aspects of public administration reform, including building up the civil servant training system with a bigger emphasis on long-term training for top and middle-level civil servants. Fourth, in order to strengthen expertise, more local experts should be contracted and the Ukrainian side should be more involved in the experts' selection—one could think about commissioning all of the TA assistance to be managed by the Ukrainian administration, preceding it with relevant preparatory help. Another issue to be solved is to increase the officials' knowledge about budget support. In order to do so, the general methodological materials in the Ukrainian language (FAQs) should be prepared, and the introductory training and seminars referring to lessons learnt in this financial perspective should be conducted frequently by the EU delegation and Ukrainian coordinator.

## Armenia: Butter Wouldn't Melt

Konrad Zasztowt

This section presents how budget support has been used in Armenia. In 2007–2013, several budget support operations were implemented in Armenia for an overall sum of €134.9 million (Table 1). The programmes have seen 85% of targets achieved on average. Some delays in paying the tranches took place when specific conditions were not achieved. Such cases are not publicized by the EU delegation, probably in order not to strain cooperation with the government. In terms of management, the Armenian Ministry of Economy is the major coordinator, while on the EU side the delegation manages the process, both in its operational and financial aspects, with a staff consisting of 7–8 people. The programming usually takes 1–2 years, while implementation of budget support operations usually lasts 3–4 years. The programmes are helped by a set of all of the usual TA tools.

**Table 1. Budget support operations in Armenia in 2007–2013**

Programme	Year	Planned financial resources (in EUR millions)	Disbursed amount (in EUR millions)
Support for Justice reform I	2008	14.9	14.9
Support for Vocational Education and Training (VET)	2009	19 (including 5 allocated in the scope of EAPIC, more-for-more rule, 2012)	13.6
Multi-Sector Budget Support (MSBS) I	2010	20	12.8
Armenia Food Security Programme	2010	2	2
Multi-Sector Budget Support II	2011	34 (including 12 allocated in the scope of EAPIC, more-for-more rule, 2013)	8
Justice reform II	2012	25	–
Support for Agricultural and Rural development	2013	20	–
		134.9	51.3

Source: The Polish Institute of International Affairs, 2013.

### The Role of Budget Support in Funding Reforms, and Major Challenges

Armenian officials find budget support a relevant aid tool. The overall package of money is an important contribution to the national budget and enables additional funding for implementing reforms where the government does not have resources in the state budget. An example is vocational education reform, which had been discussed since the early 2000s but due to a lack of funds was postponed until the EU support in 2007. Moreover, no major criticism is formulated in relation to the substance and operation of the programmes: the selected areas of support are assessed as important and timely and the planning and implementation of the operations as relevant.

The EU and primarily Armenian CSOs seem to be more sceptical of the effectiveness of budget support in the country. According to them, the results differ sector by sector and the high absorption of funds by the Armenian administration often does not translate into the implementation of adopted legislation. The watchdogs sound the alarm that the reforms are imitated, the results stay on paper and some policy areas are not of primary concern of support in Armenia.

The limits of budget support are confirmed by the varied results of the respective programmes. According to the EU delegation, the most successful area has been the cooperation in agriculture, which led to an undertaking of a general census (the first since 1988) and in vocational education, as the whole system was re-evaluated, regional centres were created, and educational programmes were elaborated. In the justice sector (93% of funds absorbed) the results were mixed. The EU financed the establishment of data lex kiosks, enabling citizens to obtain information about the process, judges and court meetings, and several laws were reviewed, e.g., on advocacy and the criminal and justice code. However, according to the watchdogs, the EU support has not led to any crucial change in the justice system due to a lack of political will to reform the corrupted judiciary system. The most troublesome were three operations in the years 2010–2012 that aimed to align Armenia with DCFTA standards in the sphere of Technical Barriers to Trade, Sanitary and Phytosanitary Standards, Intellectual Property Rights, Customs (Multi Sector Budget Support, Table 1). In September 2013, Armenia announced it planned to join the Russia-led customs union. This froze the finalised negotiations on a DCFTA with the EU, as the two customs regimes are incompatible. As a result, the EU financial assistance was reviewed and the aid for the DCFTA was stopped.

There are several reasons for explaining the shortcomings in budget support use in Armenia. First, the main difficulty lies in the lack of political will to perform the reforms, which hampers any systemic change. Some CSOs have noticed this problem and give examples of VET and justice reforms. In contrast, the major motivation of the government to cooperate with the EU is the willingness to receive additional financial means due to budget constraints, but that is not accompanied by the willingness to reform, as perceived by numerous CSOs. In this light, the “more for more” principle is not operational in Armenia and the government is creating an illusion of reform.

Second, arriving at proper conditionality, which can really trigger political leverage for reform, is problematic. In some cases the indicators are not precise enough and are not based on concrete criteria, data or benchmarks, and therefore do not allow an assessment of the results of the actions of the administration. An example here is the DCFTA operation: while the conditions for the adoption of a strategy in this field and allocating a relevant budget were agreed, there was no condition on the implementation side, e.g., checking if the state money had been actually spent on those strategies. The middle-level Armenian officials would await more specific areas and more focus on the sustainability of reform but still the problem met by the EU delegation is the difficulty in negotiating with the Armenian side the relevant conditions. At the end of the day, it would require longer negotiations in the programming period.

Third, the monitoring of budget support is very weak due to a lack of transparency of ministry activities. EU missions are relying on information provided by the government, but often the quality of the information is inadequate, i.e., an insufficient number of documents translated into English. Moreover, the EU faces a problem in identifying if EU financial assistance has been actually spent on the supported reform, as the country's PFM is not transparent enough. As the interviews show, it seems the ministries do not obtain the additional financial resources when the indicators are fulfilled. The EU delegation awaits the time when overall budget expenditures required for reforms are better evaluated by the Armenian side with the use of World Bank tools. In terms of reform cost assessment, some comparisons might be made with benchmarking in other EaP countries that have undertaken similar reforms. Budget support should be used also

to build up the capacity of the government administration in order to facilitate the reporting and monitoring functions.

The problem with the transparency of budget support is related also to the question of the information released to the public and involvement of non-governmental actors in the process. The government claims transparency is provided by state institutions via various tools, namely the placement of all necessary documents on the official websites of the ministries (e.g., the Financing Agreement with the EU in justice is public and the relevant organisations can familiarize themselves with the conditions of the budget support programme), publishing of periodic reports and brochures, establishment of National Councils that would include representatives of CSOs and private sector (National Council of the VET), etc. CSOs argue, however, that effective mechanisms that involve civil society in the process of budget support implementation are absent. They wait for EU funding for CSO projects aimed at monitoring budget expenditures on reforms. Importantly, the EU delegation started a discussion with CSOs in this respect and Armenian officials declared a willingness to introduce mechanisms for involvement of sector recipients and to improve communication with society. It would therefore give credit to the EU delegation for pushing for more involvement of CSOs in the process, for instance, in participating on steering committees. This would not, however, solve the problem of the low visibility of budget support among the general public.

Another issue hampering the process is the capacity of the national administration to implement EU aid. First, the administration lacks relevant experts knowledgeable about the EU aid system or experienced enough, which makes it difficult to have quality work done. The government officials can be divided into two groups: experienced but from the Soviet management tradition, or young with knowledge of EU rules but lacking practical experience. Such a situation results from the high staff turnover, as numerous young officials leave positions to work in international organisations, CSOs, or business. Second, the strict hierarchy in decision-making depending heavily on the highest level hampers the reform implementation pace, as without a directive from above nothing happens. The challenges of absorption capacity lead to a question of to what extent current EU TA is sufficient in this respect. According to the government, the support of technical advisors is considered important in terms of planning, managing and evaluating the process, and evidently it should be boosted. At the same time, more flexibility should be introduced in all phases. In some cases, particularly in the initial stages, training on procedures and management were lacking. Moreover, the additional international expertise via recognised international organisations is expected to be used more frequently.

## Conclusion and Country-Specific Recommendations

The government lacks the political will and capacity to implement reforms that would provide significant systemic improvements in Armenia. This seems to be the result of pursuing the policy of balance between the EU and Russia: the government is trying to satisfy both sides. In this context any EU-supported reforms are perceived by civil society activists as an “imitation.” The majority of sectoral reform conditions are assessed by the EC as fulfilled, which suggests the EU is not putting enough focus on the implementation of the agreed conditions. The potential for the future lies in the fact that there are middle-level state officials that have both the capacity and the motivation to implement reforms, however they do not have the authority and mechanisms to implement systemic changes.

The impact of EU aid on the lives of Armenian citizens is very poorly communicated. One should note, however, the EU is perceived as the potential promoter of positive and sustainable changes despite the fact that its activities are not perceived as such. The connection and cooperation

between the authorities and civil society is very low, unsustainable, and lacks positive precedents. The gap between these two seems to continue to grow.

In order to improve the overall quality of budget support and the implemented reforms via EU assistance, general recommendations are as follows. First, more detailed and measurable indicators and a more strict conditionality system are necessary to monitor results of reforms conducted by the government with the help of EU budget support. The EU should follow and oversee the process more strictly, and follow up on the commitments of the government more thoroughly. In particular, the conditionality on PFM should be strengthened, i.e., World Bank tools should be more often in use to measure progress. Moreover, the chosen reforms should be assisted by a cost analysis of their respective actions. In order to draft the detailed indicators, longer negotiations in the programming period should be held.

Second, a comprehensive institution-building programme is necessary. It should be provided by broader TA and linked to a budget support programme that motivates the changes. In particular, TA should help build up the capacity of the government administration in order to facilitate the reporting and monitoring functions. Third, there's a need for the identification and application of mechanisms for more active involvement of civil society in planning, implementing, and evaluating reforms. Consultations with respective civil society actors should be performed and cooperation with the National Platform of the EaP CSF as a party involved in the process would be an important institutional ground for involvement of civil society. The EU should also encourage the government to put forth more effort in order to increase the level of society's trust towards reform implementation processes. In terms of the Armenian government, the EU has the leverage to do so: the officials seem to be not resistant to such solutions and EU financial assistance matters to them. As the society in general is unaware of the EUs' activities, the EU delegation should play a greater role in spreading information within the country about the reform processes supported by the EU. This would allow the society to become more aware of the processes and thus more demanding of improvements. More efforts to publicise this information is required, thus bypassing usual communication activities consisting currently of publishing basic data on a website, press releases and occasional publications in newspapers.

## Azerbaijan: Just Boxticking

Konrad Zasztowt

This section presents how budget support has been used in Azerbaijan. The EU has planned relatively modest financial resources for Azerbaijan in the scope of budget support (Table 1). This is not only due to the fact that it is the wealthiest country in the EaP region and can finance its own ongoing reforms but also because of its limited absorption capacity and the execution of the “more for more” rule.<sup>1</sup> Azerbaijan has oil and gas reserves that provide significant revenue to the budget and it has a relatively stable economy. This, unlike other EaP countries, implies no great interest on the government’s behalf for financial assistance from the EU. Moreover, contractual relations with the EU are not as dense as, for instance, with Georgia or Moldova. Azerbaijan does not aim to integrate economically with the EU, therefore the scope of potential legal approximation is limited. In the years 2007–2013, four operations took place of the overall planned amount of €60 million (which is almost half of all EU assistance planned in Azerbaijan in this period), while only one operation in energy was finalised.

As a consequence, from the side of Azerbaijan’s government, budget support is rather useful in order to keep good relations with the EU, but it is not willing to undertake key reforms in politically important sectors. The implementation of budget support operations has been hampered as Azerbaijan has failed to fulfil the general condition for continuous progress in PFM reforms. Since the introduction of budget support, this issue has been problematic; but in 2013, due to the non-adoption of a new PFM strategy, the EU had to suspend payment of the remaining financial tranches.<sup>2</sup> Even though it encouraged the Azeri government to prepare a relevant roadmap for PFM and to involve NGOs in the process, at the end of the day relevant PFM reform was not pursued and Azerbaijan did not agree to separate budget support for PFM. Respondents state that under the current PFM system it is difficult to estimate in some operations to what extent the state has actually allocated money for supported reform areas, and moreover it is hard to calculate how much money the state spends on actually enacting reforms.

**Table 1. Budget support operations in Azerbaijan in 2007–2013**

Programme	Planned financial resources (in EUR millions)	Disbursed amount (in EUR millions)
Energy	13	11.75
Justice	14.5	6.44
Agriculture	13	3
Rural regional development	19.5	–
Total	60	21.19

Source: The Polish Institute of International Affairs, 2013.

<sup>1</sup> The EU offers greater incentives to countries that make more progress towards democratic reform.

<sup>2</sup> The reasons date back to 2012; they can be summarised as less-than-satisfactory progress on PFM policy reforms, including the non-preparation of a PFM Action Plan/Strategy beyond 2013.

The main coordinator of budget support is the Ministry of Economy and Industry (MEI). The ministry's coordination role is rather general and relies on TA in numerous inputs. In most cases, the line ministries manage the coordination of support: coordinating the actions that budget support seeks to underpin, which is part of their usual competences. Their coordination work is assessed positively by the EU delegation. A weakness in the system is the lack of involvement and interest of the Ministry of Finance. Its representatives rarely turn up to budget support events: they consider that budget support is MEI's "territory." The Finance Ministry was also reluctant to pursue PFM reform, which is a condition for proper implementation of budget support programmes. This predicament is of utmost importance if the EU wants Azerbaijan to pursue PFM reforms.

A specific characteristic of reform in Azerbaijan is the slow pace of the process, resulting in a low level of absorption of EU funds. First, a lengthy process of development of internal procedures for the adoption of the national system in order to absorb the EU financial support (slowed down by the pace of adoption in the Cabinet of Ministers) resulted in very late implementation of the programmes. Second, budget support operations in Azerbaijan are much slower than in other EaP countries due to the long process of negotiation with the government (lasting around two years). Azerbaijan's ministries do not perceive this as a problem or they simply blame it on the EU having too demanding procedures. Some problems are also met in terms of the frequency of the steering committee meetings, which may suggest not enough engagement by the Azerbaijan administration.

### The Role of Budget Support in Funding Reforms, and Major Challenges

The advantage of budget support as assessed by the Azeri government is that it can help in guiding some sector reforms. For some ministries, cooperating with the EU and having the will to reform is visible. For Azerbaijan officials (from the ministries of agriculture, justice, industry and energy), the EU role is important namely because EU experts help advise on and monitor the reform progress. It seems Azerbaijan is making use of the EU assistance to reach its own objectives. This, by the way, explains the length of the negotiations as the Azeris aim to ensure their own interests. In this light, the EU can help to direct the reform. In the rural development programme supporting ongoing and planned reform by the Azerbaijani government, some of the indicators have been pursued even though the EU tranche had been blocked due to the PFM issue. For Azerbaijan, the EU money itself was often not of value (it financed only a minor part of the national strategy). The government had no problem with continuing with the reform (creating economic zones, business facilities, increasing access to credit for SMEs). Interestingly enough, to maintain good personal relations with the Ministry of Justice, cooperation could have even been launched in such a sensitive area as justice. While obviously the justice system is highly dependent on the executive, the budget support programme enabled the achievement of some results, such as courses for judges or the creation of legal advisory centres outside Baku. For instance, a representative of the Ministry of Industry and Energy has expressed the need for more intensive contacts with the EU in this respect.

The problem is that in the programmes much focus is placed on the legislative part of the process, while implementation is lacking. This was visible in the agriculture programme. In this field, the issue was the introduction of phytosanitary and veterinary standards due to Azerbaijan's desire to join the World Trade Organisation. So far, the programme consisted of three components: food security, food safety, and higher education in agriculture. This led to setting up a food security early warning system and the construction and development of new grain elevators. In the scope of energy operations, a strategy on renewable energy and its respective legislation was prepared but has not yet been adopted. This resulted in non-payment of parts of the final tranche. A positive, however, is that the State Agency for Alternative and Renewable Energy Sources (SAARES) was

created. As an institution under the Ministry of Industry and Energy with a significant degree of autonomy, it is more flexible in terms of undertaking action and it is developing regulations in the field of alternative and renewable energy.<sup>3</sup>

To some extent, this suggests that the scope of EU conditionality should be rethought. Some respondents suggest that some of the conditions the EU puts forth are formulated imprecisely (e.g., no clarity as to whether the legislation applies or only if the actual implementation of the reform is carried out). Some Azerbaijani government officials pointed to the excessive demands placed by the Union as a condition for the payment of the next tranche of budget support. An example given was agricultural reform. The EU delegation explains that all specific conditions were negotiated before the signing of the financial agreement, and in case of problems with its implementation, the government is given more time. In case of problematic conditions with public finances, this is the general condition of budget support use in any country. Another problem is that conditionality may become outdated, e.g., in the justice operation there was support for 51 prisons, but the government decided to merge some and reduce the number of facilities.

A deficit of the system is transparency, which is lacking in national budget expenditures and in the PFM system through which funds flow. There is a need for PFM reform and strengthening national audit institutions. In addition, the engagement of NGOs in this field is relatively low, as the government is very resistant to such collaboration.<sup>4</sup> Representatives of Azerbaijani civil society organisations point out that their participation in the monitoring of planning reforms, as well as their subsequent implementation is minimal or non-existent. According to them, the EU should put as a condition for the Azerbaijan government the inclusion of civil society actors in monitoring these areas. An EU success in this respect was its push for the involvement of some think tanks to cooperate on PFM issues. In other cases this is extremely difficult and crossing the government's red line on this would risk the EU not concluding an agreement at all.

In terms of visibility, the EU delegation issues press releases, produces brochures and arranges conferences or workshops (e.g., on energy). Currently, more innovative solutions are being discussed. Definitely there is a need to increase the visibility and promote the actions supported, for instance, the creation of legal clinics for the population, support for access to working skills in penitentiaries, etc.

## Conclusion and Country-Specific Recommendations

Given the stable economic situation in Azerbaijan, as well as the relatively small amount of funds allocated by the EU for budget support in the country (which represent a minor part of Azerbaijan's budget), this instrument cannot be the tool to encourage the government to start comprehensive reforms, such as the key PFM reform. Budget support, however, has a fundamental advantage: it obliges the government to work closely with the EU. By cooperating through budget support with the government, it is possible to go to the substance of the reform and change at least partially the situation, which is impossible with other tools, such as TA. It is therefore necessary to continue budget support for projects that can contribute to the reform of certain economic activities or institutions of particular importance to Azerbaijan (e.g., in energy, regional development, and

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<sup>3</sup> In 2011, the agency in cooperation with UNDP, launched the "Promoting Development of Sustainable Energy in Azerbaijan" programme, which was supported by a sum of €500,000 by the European Commission and \$790,000 by the Norwegian government.

<sup>4</sup> In early 2014, legislation was passed that makes the registration and operation of NGOs difficult. As a result, pro-European organisations especially might be even more restricted in their attempts to control government activities.

agriculture or at least in some areas within these reform areas). Successes in even these limited spheres can show policymakers and the public the benefits of cooperation with the EU.

Some steps should be taken in order to improve the programme's approach. First, it is necessary to narrow the supported areas, perhaps even choosing the right cluster within a specific sector so it might serve as a "pressure point" leading to improvement in the sector overall. Second, the EU should consider whether fewer conditions would not lead to better results in order to make the support more focused. Third, budget support should be assisted by other aid tools, such as twinning and grant projects.

In terms of institutional solutions, Azerbaijan's Ministry of Finance must be involved in the process and consulted more often. This will not be easy, but the EU should insist more strongly on a Ministry of Finance commitment and involvement in budget support operations. This cooperation should also involve a discussion of PFM issues so that the use of funds, including those from the EU, becomes more transparent. In addition, it is necessary to establish a proper mechanism to conduct internal monitoring, which would include at least in some programmes representatives of Azerbaijani CSOs, and evaluations made by them should also be taken into account.

The visibility and transparency of EU activity in Azerbaijan are key areas to work on. The information about budget support should not be focused on publicizing data on the size of budget support, which does not matter much for the budget of Azerbaijan. It is rather necessary to promote the positive changes as a result of measures taken by EU aid reform. Moreover, the EU should pressure the government to incorporate to a greater extent cooperation with representatives of civil society, despite their difficult situation due to the authoritarian nature of the government. Even so, it is necessary to include some conditions in this respect. In order to allow public scrutiny of reform and strengthen the pro-EU environment, it's crucial to discuss with civil society leaders different sector reforms. CSO involvement might be ensured at several levels. First, the EU can demand that some CSOs be involved on steering committees. In less political sectors, e.g., agriculture, the government should be more open to meet such claims. Second, the EU delegation might on its own meet with CSOs at the design consultation stage to determine whether the priorities in a given sector are going to have a wider social impact (e.g., on rural communities); in the design of indicators in some areas (e.g., if business associations suggest some SME indicators); and on the implementation of the programmes.

## A Cross-Country Picture: Towards More Efficient EU Aid

Elżbieta Kaca

The EU approach in the Eastern Partnership countries is to financially support concrete reforms: sector budget support operations are most commonly in use. Theoretically, such a tool, given teeth by precise conditions and indicators, should allow the smooth completion of the sector integration planned in the scope of the EaP. In practice, an analysis of the first years of use (2007–2013) shows that this instrument has potential in countries willing to integrate with the EU, while in the others its use has limited impact on guiding comprehensive reforms.

The pace of fulfilment of budget support conditions differed much among the partners. This resulted mainly from the various level of willingness of the EaP governments to conduct EU-oriented reforms. For Moldova and Georgia, the political will to integrate with the EU is clear, as proved by their determination to sign an AA. On the contrary, Armenia and Ukraine withdrew from signing such deals, a step that confirmed they were not interested in or were hesitant about EU-backed reforms. In Armenia, the EU had to stop support for DCFTA implementation and reshape its assistance, whereas for Ukraine the new pro-European government has signed the political part of the AA after an internal crisis. Azerbaijan is a case apart, as budget support was aimed to develop sector cooperation, but in the meantime it has shown it is not interested in complying with aid conditions on PFM: in this case, the EU help is rather useful in terms of advice on the directions of some reforms. Therefore, one can distinguish two groups of countries, EU-oriented and non-EU-oriented, with the latter being interested only in some sector cooperation.

For the first group, meaning currently Moldova and Georgia and most probably also for Ukraine (due to the recent political changes), budget support seems to be a worthy tool and fits into the integration efforts of those countries. In relation to the latter group, the use of budget support proves to be troublesome. The basic problem with them is fulfilment of the general PFM conditions. In Ukraine and Azerbaijan, the situation has deteriorated much in this respect, and despite EU efforts to push for improvements, no results were obtained and the support had to be ceased. Both countries argue that budget support aid should not be linked with PFM. From the EU perspective, this is a basic condition enabling at least a partial check of whether the money has been allocated from the state budget for concrete reforms. For Armenia, the transparency of budget support implementation also poses a challenge but is less obvious: the government fails, for instance, to deliver proper documentation.

Another characteristic of the EU-reluctant states is that the EU's role in directing the whole process of reform is very limited, as the partners are very reluctant. First, at the level of negotiations it seems it is hard to negotiate concrete indicators. Second, there is a visible tendency to bid EU aid on concrete activities to be performed and not link the EU money to overall performance of the reform. Third, much depends on personalities in concrete ministries and their willingness to cooperate with the EU. All those features do not mean, however, there is no room for manoeuvre for the EU. It can be seen that in all of the countries at the middle-management level there are some officials interested in cooperation with the EU and some sectors of common interest might be found. The question, however, is how to upgrade actions at the higher political level. This could be dealt with by demonstrating to the EU's partners the benefits of this engagement going beyond mere financial aid. For instance, in Azerbaijan, EU support is used to guide and give pace to the country's own reform efforts.

A comparative picture of budget support in these five Eastern Partnership countries shows numerous similarities. It helps with legal approximation to EU standards in various sectors. This makes budget support, based on the results, a more efficient tool than other advisory instruments. In this light, the advantage of budget support is that it can help in guiding some sector reforms. For non-EU-oriented countries, budget support has a fundamental advantage for the EU: it obliges the government to work closely with the Union. By cooperating through budget support with the government it is possible to go to the substance of the reform and change at least partially the situation, which is impossible with other tools. Therefore, budget support can be used to cover reform of certain economic activities or institutions of particular importance for such countries on the condition they align with the PFM condition. In order to make budget support more efficient as a tool, several challenges in common for all EaP countries must be addressed.

The biggest problem seems to be the fact that budget support operations lead to legislative changes but still fail to address the implementation side of reform, meaning relevant actions by the government to enact the reform are not undertaken. There are various reasons for this. One problem is that the engagement of relevant ministries in implementation is lower than it could be as funds are placed with the state budget and the ministries do not receive this aid directly. A major difficulty may lie, however, in the fact that the conditions are not shaped properly. The EU tries to support too many goals in a particular sector and the conditions are sometimes too ambitious or too broadly formulated, rendering the expectations simply unrealistic. The art of drafting workable conditions is a complex task and the EaP officials' contribution to this planning phase is limited due to the usual lack of policy analysis units. The lack of reforms is also due to a lack of cost analysis estimates, as administrations have limited capacities to prepare the information. The EU, for its part, avoids such calculations as it fears the aid would be treated as insufficient by the recipient. Moreover, TA experts do not help much in drafting proper conditions due to the lengthy procedures and because they are usually commissioned one year after the operation starts. At the end of the day, whenever there are conditions enabling numerous interpretations the results can be assessed in numerous ways.

One source of the problem is that in every country the programming period lacks wide consultations with stakeholders other than the government to discuss if the selected conditions are the most relevant. The programming of budget support was usually assessed as inclusive, but only in terms of involving national officials. The EU's choices of reform areas were deemed correct in terms of meeting first the country's needs. One criticism was related to the fact that the EU has the right to choose the spectrum of sectors, thus limiting the partners. Usually, however, no major problems were met when negotiating the planned reforms and conditions. Another problem is the lengthy programming period, lasting around 1-2 years, which limits flexibility in reaction to political changes. In some cases, the practice proved that holding longer negotiations on the indicators brought better results in terms of arriving at realistic conditions.

In all of the EaP countries, the weakness of public administration seems to be a factor that hampers implementation. The usual problems are weak interministerial coordination, an overly large hierarchy hampering the decision-making process (though in a relatively good situation in terms of flexibility in the bureaucracy is Moldova and Georgia), turnover of high officials, and insufficient preparedness of officials (in terms of understanding of budget support mechanisms, project management, and language skills). EU TA to a limited extent supports capacity-building of administration. The usual problem in this respect is that TA is employed to deliver the duties of the officials (i.e., drafting monitoring reports that should be delivered instead by the national administration) instead of co-working and transferring skills to the recipient. In addition, according to some interviewees, sometimes TA experts are not sufficiently knowledgeable about the country's particular situation and relevant sector, which hampers the effectiveness of their expertise.

Special notice must be paid to the system of budget support coordination at the EaP country level. The lessons learnt, namely from Georgia, is that a crucial stakeholder for the EU in the process should be the Ministry of Finance, which is the direct recipient of EU money, has financial leverage over the other ministries, and manages the public finances and ensures transparency. The lack of engagement of the Ministries of Finance in Azerbaijan and Ukraine was one of the reasons for problems in the implementation of budget support in those countries. At the same time, such a powerful Ministry of Finance needs to closely cooperate with line ministries and, more importantly, with the body responsible for overall supervision of international aid, including that from the EU. Another issue is also the lack of monitoring mechanisms of the implementation of budget support at a national level (by civil society and the administration itself). This results in a situation in which it is difficult to collect the required information and data about each line ministry's performance.

In all of the EaP countries, the EU is blamed for excessive bureaucracy that limits flexibility. As budget support is long-term aid and usually lasts around three years, this problem arrives whenever political priorities change due to elections and because of top-level position switches. This modality is also highly inflexible in terms of changing the indicators once the financial agreement is signed.

Another common factor is low social endorsement and low visibility of EU-supported reforms, which results in low social pressure on the government to complete the reform. At the programming level, there are rare examples of wide consultations with all stakeholders (some best practices in Georgia). Then at the implementation stage there is very little involvement of watchdogs to monitor implementation. In most cases (again, besides Georgia) the representatives of NGOs are either not invited to the monitoring committees and have limited access to the information or their participation in it is only *pro forma*. Last but not least, final results are poorly communicated, usually limited to some press releases, and additional communication activities are rarely undertaken (i.e., transport budget support in Ukraine). EU officials complain that budget support is too abstract to communicate to citizens and there is no one interested in it. On the other hand, some reflection in the delegation is made on the need for more innovative information campaigns.



## Notes about the authors

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