

SPECIAL REPORT No 7/87

on

the management of counterpart funds in respect of food aid
together with the replies of the Commission

(88/C 31/02)

(Observations pursuant to Article 206a (4) of the EEC Treaty)

TABLE OF CONTENTS

	Paragraph Reference
1. Introduction	1.1 — 1.5
The objectives and mechanism of counterpart funds	1.2 — 1.5
2. The results of the survey by questionnaire	2.1 — 2.26
Opening the counterpart account	2.1 — 2.5
Observation	2.6
Financing the counterpart account	2.7 — 2.16
Observation	2.17
The use of counterpart funds	2.18 — 2.23
Observation	2.24
Monitoring of counterpart funds	2.25
Observation	2.26
3. Examination of counterpart accounts in Niger, Burkina Faso and Egypt	3.1 — 3.20
Niger	3.1 — 3.7
Opening the counterpart account	3.1
Financing the counterpart account	3.2 — 3.5
The use of counterpart funds	3.6 — 3.7
Burkina Faso	3.8 — 3.13
Opening the counterpart account	3.8 — 3.10
Financing the counterpart account	3.11
The use of counterpart funds	3.12 — 3.13
Egypt	3.14 — 3.21
Opening the counterpart account	3.14 — 3.15
Financing the counterpart account	3.16
The use of counterpart funds	3.17
Supervision of the counterpart account	3.18 — 3.20
4. Conclusion	4.1 — 4.3
	Pages
Replies of the Commission	27 — 30

1. INTRODUCTION

1.1. In 1985 and 1986, the Court of Auditors carried out a general survey based on a questionnaire sent to the 45 Commission delegations which were responsible, for 50 recipient countries, for food aid intended for sale, in order to find out how these countries managed the counterpart funds generated by such sales. An analysis of the replies received shows that the main problems relate to the opening and financing of the counterpart accounts and the utilization and monitoring of the funds deposited in them. The first part of this report analyses these various aspects of the management of counterpart funds. The Court has also taken care to check these same factors directly, in Niger, Burkina Faso and Egypt. The results of these on-the-spot findings are set out in the second part of the report. They constitute a specific illustration of the findings of the general survey.

The objectives and mechanism of counterpart funds

1.2. When counterpart funds are implemented, they are a vital factor in the management of Community food aid. Such aid complies with principles which, at the time of the Court's survey, were set out in Council Regulation (EEC) No 3331/82 of 3 December 1982 ⁽¹⁾. Counterpart funds must comply primarily with two of the objectives prescribed by this legislation:

(a) first objective:

food aid must 'contribute towards the balanced economic and social development of the recipient countries' (Article 2 (1) of Council Regulation (EEC) No 3331/82 ⁽¹⁾);

(b) second objective:

Article 2 (3) of Council Regulation (EEC) No 3331/82 also states that: 'The granting of food aid shall, if necessary, be conditional on the implementation of annual or multi-annual development projects, priority being given to projects which promote the production of food in the recipient countries. Where appropriate, the aid may contribute directly to the implementation of such projects. This complementarity may be ensured through the use of counterpart funds where the products supplied by the Community as aid are intended for sale.'

1.3. Regulation No 3331/82 ⁽¹⁾ clearly contained lacunae and ambiguities. On 22 December 1986, the Council adopted a new regulation to replace it, namely Regulation (EEC) No 3972/86 ⁽²⁾. This regulation considerably clarifies the Community's policy on this question. It stipulated in particular (Article 2 (2)) that 'where (this aid is) sold, the price thereof must not be one liable to disrupt the domestic market'. It also lays down (Article 2 (5)) that, when the granting of food aid is conditional on the implementation of development projects or programmes, 'this complementarity shall be ensured through the use, laid down by common agreement, of counterpart funds where the products supplied by the Community as aid are intended for sale'.

1.4. However, right from the beginning of the period covered by Regulation No 3331/82 ⁽¹⁾ (which is also the period covered by this report), the Commission concluded delivery agreements on a case-by-case basis with the recipient countries, the detailed provisions of which foreshadowed those of Regulation No 3972/86 ⁽²⁾. The standardized text of these provisions was reproduced, throughout the period 1982-86, from one agreement to the next and for all the recipient countries. Apart from a very small number of exceptions, each delivery agreement lays down that:

- (a) the beneficiary shall open a special account with his central bank, in order to credit to it the proceeds of the sale of the food aid received;
- (b) the price at which the product supplied was sold on the market must serve as a reference for the purpose of crediting the account;
- (c) the funds credited in this way must be allocated to the financing of one or more development projects according to procedures which should be worked out between the recipient country and the Community and which should, in any event, according to Regulation No 3331/82 aim, as a matter of priority, to promote food production in the recipient countries.

1.5. The Court carried out its investigations with reference to the legal basis provided by the terms of the delivery agreements, drawn up by contract between the Commission and the recipient countries. Its first objective was to find out to what extent the agreements concluded had or had not been observed and to assess the seriousness of the infringements. Its second objective was to examine, in the light of these infringements and the context in which they had occurred, whether some of the provisions of the delivery agreements should be amended, with a view to simplifying them, or in some cases, on the contrary, filling in loopholes.

⁽¹⁾ The footnotes appear together at the end of the report.

2. THE RESULTS OF THE SURVEY BY QUESTIONNAIRE

Opening the counterpart account

2.1. The principle of a single account opened at the central bank of the recipient country has only partly been observed. The discrepancies in relation to the conditions laid down concern the following points:

- (a) recourse to a financial institution other than the central bank;
- (b) the opening of multiple accounts;
- (c) the amalgamation of resources generated by Community aid with those provided by other donors.

A total of more than two-thirds of the accounts examined during the survey did not fully comply with the requirements laid down in the delivery agreement. This is hardly surprising, as it may prove to be difficult — if not impossible — to observe the provisions laid down.

2.2. As regards the question of the central bank, a problem arises if this institution is not of an appropriate kind, or if it functions as the central bank of several different countries. Delivery agreements drawn up according to a standardized model do not allow for any adaptations to suit local circumstances, although it is sometimes appropriate to entrust the management of the funds to other types of financial institution, including even commercial banks. Altogether, counterpart fund accounts have been opened with institutions other than the central bank in 17 countries.

2.3. The opening of multiple accounts was noted in 13 countries. This multiplicity often results from purely chance circumstances:

- (a) after several unsuccessful attempts, it was at last possible to implement a real counterpart funds system, thanks to the opening of additional accounts (see the case of Burkina Faso, paragraph 3.8 below);
- (b) the idea has at times gained ground that opening a special account to collect the proceeds of the sale of each branch of Community aid or to enable projects to be financed individually would allow the operation of the account to be monitored more easily. In practice, the reverse is true: multiplicity of accounts complicates administration and does not facilitate controls.

2.4. In about 10 recipient States, one and the same account lumps together the proceeds of sales of aid from various Community and non-Community sources. In such cases, the possibility of monitoring counterpart funds is broadly dependent on the existence of subsidiary accounts or the keeping of supplementary accounts specifically for Community aid. It is only possible to accept a joint account for all donors in quite exceptional cases, such as that of Mali, where international aid is subject to coordinated management.

2.5. In most cases, the opening of irregular accounts seriously disturbs not only the monitoring, but also the actual operation, of the system. For this reason, in cases where draconian steps taken by the delegations have enabled accounts to be opened or brought into line with the legislation, the improvements achieved have gone beyond simply regularizing matters from the formal point of view. It is possible to envisage the funds being utilized and monitored under far better conditions. However, the survey carried out shows that the counterpart account was established in accordance with the delivery agreement in about 15 countries at the most.

Observation

2.6. Such a situation compels the Commission, on the one hand, to revise the 'standard' text of the delivery agreements and, on the other hand, to attempt to adapt it to the specific realities of each recipient country. In this connection, it is clear that recourse to private financial institutions would sometimes eliminate a number of problems, by removing any temptation to confuse the counterpart funds with those belonging to the State budget, and by simplifying the monitoring of the operation of the accounts, on both the credit and debit sides.

Financing the counterpart account

2.7. In its examination of the financing and operation of the counterpart funds, the Court came up against the first major obstacle. Nowhere in the Commission files is there an overall summary of all the revenue generated in the recipient States by the sale of food aid. This observation applies in particular to the use of resources generated in this way and to the balance of the funds remaining available on the accounts as a whole. All that is available is piecemeal information, which is not always up-to-date, in certain of the Commission's files.

2.8. According to section 2 of Annex I to the delivery agreement signed with each country in receipt of food aid,

it is normally the price at which the product supplied was sold on the market that should serve as a reference for the purpose of crediting the account. The stage to be taken into consideration (wholesale or retail) is not specified. From the results of the survey, it is not possible to draw up an exhaustive table of the amounts that would result from the strict application of the delivery agreements in all the countries concerned, but the survey reveals serious and similar shortcomings in the implementation of the system.

2.9. On account of losses occurring during marketing and transport within the country (in addition to shipping losses), the quantity acknowledged as having been sold — and therefore the amount to be paid into the fund — is reduced. The Court is unable to estimate the total extent of the resulting shortfall. However, through concrete examples observed during on-the-spot visits, the Court was able to establish the frequency of such losses which, cumulatively, may exceed 5 % of the initial consignments.

2.10. Some aid did not generate any counterpart funds, on account of the conditions under which it was granted by the Community. Recipient countries cannot be asked to sell aid products that are of very poor quality (see paragraphs 3.3 and 3.11 below).

2.11. In eight countries the Court noted that, contrary to the terms of the delivery agreements, the aid had not been paid for in money. In Angola and Mauritania, the Community was faced with a '*fait accompli*'. In the other countries, the delegation acceded to requests from the local authorities. The actual situation of the economy of the recipient country in cases like this makes it difficult to distinguish a priori between situations where aid could be paid for and those where it could not. There is a grey area where the tendency to increase the proportion of aid distributed free of charge or at very low prices cannot be prevented, mainly on account of the inadequacy of the purchasing power of the populations concerned.

2.12. Even when the aid is sold, the amounts credited do not always correspond to the price that would actually result from selling it at genuinely market-clearing prices, and the consequence is usually a reduction in the amounts credited to the special account. In fact, in a number of countries, prices are fixed administratively and/or without real reference to the local market. These sales made at artificially low prices discourage local producers and help to exclude them from economic and social life.

2.13. It is not always possible to obtain a market price for a particular product, either because the product is not produced locally, or because it is difficult to calculate the value of it objectively. In such cases the Commission agrees to take a different basis of reference (usually the c.i.f. value of the product on the world market). The delivery agreements, however, say nothing on this point and should therefore be revised accordingly. A substitute price is used in one quarter of all cases. The Commission should examine the use of this approach country by country and product by product and should keep a close watch on the

values used. For example, the choice of an f.o.b. Europe value means that the maritime freight cost, at the c.i.f. value, is deducted *de facto* from the proceeds.

2.14. The delivery agreements state that the proceeds of the sale are to be paid into the counterpart fund account. They also provide that the beneficiary country is to inform the Commission of the normal marketing costs. Provisions of this kind do not give authorization for the related costs of maritime transport, in the case of aid granted at the f.o.b. stage, or of transport within the country, or of marketing, be they real or notional, to be deducted from the gross revenue received. Still less do they stipulate what expenses, if any, are eligible for deduction. The Commission's interpretation of delivery agreements is too favourable to beneficiary countries, in that it does not disallow deduction of marketing costs, where this is practised, and does not encourage delegations to take action where such deductions are made.

2.15. In seven countries customs duties in respect of food aid operations are included in the selling price and the corresponding amounts are not paid into the special account. There are two different elements to be criticized here:

- (a) firstly, the Commission must ensure that beneficiary States do not levy Customs duties on gifts which they receive from the Community;
- (b) nevertheless, if in cases of this kind the sales price of goods is set at a level equivalent to the import value plus the value of the customs duties for equivalent products, in order not to disrupt the local market, this ought not to result in the creation of an additional resource for the budget of the beneficiary State: instead, an amount corresponding to the customs duty should also be credited to the counterpart account.

2.16. Finally, sums which are acknowledged to be payable to the counterpart account are sometimes not in fact paid into it. The sum is then acknowledged to be owing to the account.

Observation

2.17. In all cases the 'sales price' in calculating counterpart funds should be at least equivalent to the c.i.f. price of the product valued at the price ruling on the world market, but should also be set at a level which does not disrupt local production. The deductions that may be made should be harmonized between countries and should be fully and accurately defined in the delivery agreements. The aim is therefore to arrive at a system for setting prices which will be clear, simple and verifiable and will ensure that there is a close correspondence between the sums actually received

after deduction of marketing-related charges and the amount to be paid into the special account. The method of calculating the amount which the country undertakes to pay into the counterpart fund should therefore be agreed in advance between the Commission and the beneficiary State.

The use of counterpart funds

2.18. The funds entered as revenue in the counterpart accounts must be used by the recipients of food aid. In the delivery agreement, the recipients undertake to use these funds solely for development projects or programmes, preferably in the rural sector or the agri-foodstuffs sector. The delivery agreements make no mention of the procedure according to which decisions on the financing of projects or programmes are to be made. In a number of cases, particularly those of Egypt and Peru, the Commission shows a tendency to place the funds under joint management, most often by making their release conditional on the signature of the Commission's delegate, in addition to that of a representative of the recipient State.

2.19. This joint management has some advantages. Nevertheless, the Court does not recommend amending the text of the delivery agreements so as to make such a provision generally applicable. Indeed, disregarding any political problems, the use of two signatures or any procedure of the same type incurs the risk — which cannot be underestimated — of slowing down the financing operations for development projects or programmes.

2.20. Up to now, the main problem has in fact been how to make rapid use of the funds which ultimately become available and allocate them to finance projects which will help to improve the food situation in the country. In those beneficiary countries in which the funds have been correctly constituted, they are used too slowly, or even not at all.

2.21. According to Regulation No 3331/82, the funds should be allocated, as a priority, so as to finance development projects aiming to promote food production and in 75 % of the countries covered by the inquiry, the counterpart funds were indeed used for projects in the agri-foodstuffs sector and did actually make a contribution to national development. However, the delivery agreements do not generally lay down any very precise obligations, since they refer to 'development projects' to be implemented 'according to procedures to be established between the country receiving the aid and the Community'. Whatever reasons may have led the Commission and the recipient States to extend the field of operations financed by the counterpart funds, there is an excessive lack of precision in the whole of this legislation.

2.22. As a result, the funds were used to provide emergency aid to the indigent and to the victims of drought, to defray the cost of transporting aid within the recipient country and to finance technical assistance with a view to creating and running a food strategy coordination unit in one recipient country.

2.23. Funds are also increasingly used directly by agricultural intervention organizations, generally public ones:

- (a) the funds paid over are often used to cover overheads or trading deficits, or to provide starting capital when they are set up;
- (b) these intervention agencies are often used to subsidize consumer prices. One of them pointed out that produce was resold at a price below the cost price to the State;
- (c) moreover, they do not receive appropriate budgetary resources for the responsibilities assigned to them when, for example, they are instructed to distribute aid which is not intended for sale;
- (d) these organizations have used funds in the form of working capital to finance seasonal purchases, on the pretext that they did not have appropriate liquid resources. This implied that the deficiency would be made good after the products thus acquired had been sold. In some cases, however, the authorities had them distributed free of charge and on this occasion, contrary to expectations, the sums disbursed were not made good.

Observation

2.24. The Court must draw the Commission's attention to the problems of control posed by the operations described above. Counterpart funds are supposed to contribute towards increasing agricultural production in countries which are suffering food shortages; this aim is mainly achieved by financing investments in the field of agricultural production. From a financial point of view, the funds should be used so as to give practical expression to the principle which has been emphasized by the Community budgetary authorities on many occasions, namely

that, far from helping to undermine local agricultural systems, food aid must make it possible to strengthen them and gradually render external food aid unnecessary. It is important to ensure, therefore, that food aid resources are correctly marshalled and then used to contribute to the realization of this objective of self-sufficiency in foodstuffs. With regard more particularly to the financing of intervention agencies, there are major practical reasons for proceeding with extreme caution, since it is particularly difficult to monitor this type of financing and its adverse effects on the agricultural sector are always to be feared. Reliable management of a central intervention agency is something which is not within easy reach of the States concerned, as successive audits carried out in these agencies have shown.

Monitoring of counterpart funds

2.25. Under the delivery agreements, the recipient States are required to provide the Commission with quarterly reports on the quantities sold and annual reports on the operation of the counterpart account. The Court noted that, with very rare exceptions, these reports were never filed by the recipient States. The information which the Commission has at its disposal on the quantities sold and the operation of counterpart accounts is nevertheless quite considerable. However, it is obtained by the delegations, in a patchy and incomplete manner, after repeated requests, and too long after the deliveries have been made.

Observation

2.26. The Court suggests that the provisions of the delivery agreements relating to the filing of quarterly and annual reports should be relaxed, so as to bring them more realistically into line with the administrative capabilities of many of the recipient countries. The main thing is not to get them to write reports, but to insist that they keep accurate and up-to-date accounts, showing, on the revenue side, the value in local currency of each delivery and, on the expenditure side, the cost of each development project financed. It is also essential that, once these accounts have been drawn up with the utmost accuracy, they should be accessible to an official in each delegation who would be responsible for monitoring them constantly. This is, moreover, the course of action which a number of delegations are automatically tending to follow. Once the terms of the delivery agreements have been amended, precise instructions — which is what the delegations have so far lacked — should be issued with this objective in mind.

3. EXAMINATION OF COUNTERPART ACCOUNTS IN NIGER, BURKINA FASO AND EGYPT

Niger

Opening the counterpart account

3.1. In Niger the funds are deposited in a single account opened with the Development Bank of the Republic of Niger (DBRN), whereas the agreements, drafted in the usual terms, implied that the funds should be paid to the central bank, in this case, the Central Bank of the States of West Africa (CBSWA), an interstate bank. No doubt it was preferable to use a purely Niger financial institution. Appropriate specific provisions should, however, have been included in the delivery agreement.

Financing the counterpart account

3.2. The total value of the 'for sale' aid received by Niger since 1981 is in the region of 3 500 Mio CFA.F ($\pm 10,2$ Mio ECU) (average value at the world market price). The delegation calculates that the actual proceeds of the sales amounts to 1 554,62 Mio CFA.F ($\pm 4,5$ Mio ECU). The Niger authorities, for their part, appear to estimate this amount at 1 473,36 Mio CFA.F ($\pm 4,3$ Mio ECU). They have, however, only credited the account with 693,3 Mio CFA.F ($\pm 2,0$ Mio ECU). The difference between the value of the aid and the amount credited to the account is almost 3 000 Mio CFA.F ($\pm 8,7$ Mio ECU). There are various reasons for this difference, as may be seen below.

3.3. An amount of 2 200 Mio CFA.F ($\pm 6,4$ Mio ECU) may be accounted for in terms of losses in respect of the quantities supplied, the poor quality of the deliveries (in particular, in the case of one sub-standard delivery of 25 000 t of cereals representing $\pm 3,7$ Mio ECU), a price which was particularly low, or reduced to zero (free distributions authorized by the Commission) and various deductions. A flat-rate deduction for costs of 30 CFA.F/kg was granted in respect of all products delivered, irrespective of the value of the product. It is reasonable to ask whether, in this specific case, the costs involved were normal marketing costs, since there was no justification for the level of the deduction made. The level of the flat-rate deduction in the case of maize ($- 30\%$) was too high and greatly reduced the amount credited. It is by no means negligible for the products of a higher unit value (11 % for skimmed-milk powder and 16 % for rice). And, in any event, such deductions are not stipulated in the delivery agreements.

3.4. The delegation considered that a supplementary amount totalling 81 Mio CFA.F ($\pm 0,2$ Mio ECU) was still owed by the Office for Food Products of Niger (OFPN), but

it had not attempted to explain the causes of the difference, which may just as easily lie with the prevailing prices as with the quantities offered for sale.

3.5. The OFPN acknowledges that it still has to pay into the account an amount totalling 780 Mio CFA.F (\pm 2,3 Mio ECU).

The use of counterpart funds

3.6. In July 1985 payments totalling 677,4 Mio CFA.F (\pm 1,97 Mio ECU) were made to Niger from the counterpart fund. Outstanding commitments amounted to 15,9 Mio CFA.F (\pm 0,05 Mio ECU). All of these financing operations related to agricultural development projects, in accordance with the terms of the delivery agreement.

3.7. The Commission entered into negotiations with the Niger authorities to examine how to use the remaining counterpart funds of 1 554 Mio CFA.F (\pm 4,5 Mio ECU) resulting from the sale of Community food aid. This actually involved 861 Mio CFA.F (\pm 2,5 Mio ECU) in claims not paid into the account, of which 780 Mio CFA.F were acknowledged as being owed by the Niger authorities. The option of incorporating them into the OFPN's capital in order to strengthen its financial structure was envisaged. In reality, everything suggests that this was purely an accounting trick, designed to cover former deficits or the OFPN's operating expenses, without any guarantee being given in respect of the restructuring of the Niger cereals markets, which is, however, necessary.

Burkina Faso

Opening the counterpart account

3.8. At least three special accounts were opened successively. A first account, opened at the Treasury, did not comply with the legislation and has never operated correctly. A second account with the CBSWA, which has already been mentioned, has practically never been used, since the proceeds of only one single sale have been paid into it. The amount thus credited in April 1984 was transferred in May 1985 to a third account which had been opened since July 1984 at the International Bank for Trade, Industry and Agriculture (IBTIA). The balance of the account opened at the Treasury should also have been transferred to this financial institution, but in fact this was not done.

3.9. The opening of a single bank account for the counterpart funds obtained from the sale of Community aid products presupposes that the types of aid do not differ too greatly. The movements of funds relating to normal food aid (Regulation (EEC) No 3331/82 ⁽¹⁾) and the repayments effected within the framework of the special programme for the fight against famine in the world were made from and to the same account. However, monitoring each of these two types of aid involved completely different requirements. In the case of normal food aid, the important thing is to ensure that the funds credited are in line with the provisions of the delivery agreement and that they have been used quickly and properly. In the case of the special programme, the important thing is that the initial subsidy has been made good which is difficult to monitor if one and the same account is used. The accounting procedure adopted should take account of this requirement.

3.10. The use of a private bank, such as the IBTIA, does not comply with delivery standards either. It does have two advantages, however: the funds are managed normally, whereas the precarious situation of the Treasury of Burkina Faso might otherwise result in delays in the flow of funds, and the IBTIA, unlike the Treasury and the CBSWA, pays interest on unused funds.

Financing the counterpart account

3.11. The sales prices applied to calculate the funds appear to be acceptable, which means that the amounts in the account, representing 2 553 Mio CFA.F (\pm 7,0 Mio ECU) since 1976 must themselves be recognized as acceptable. Some difficulties have been encountered, however:

- (a) the quality of a delivery of 8 000 t of maize made under the 1985 programme was questioned. Its value appears to have been in the region of 500 Mio CFA.F (\pm 1,5 Mio ECU), which were not credited to the account;
- (b) as at 31 December 1984, the intervention agencies had not paid an amount of 1 337,3 Mio CFA.F (\pm 3,9 Mio ECU) into the special account. On 15 September 1985 this amount was reduced to 159 Mio CFA.F (\pm 0,5 Mio ECU) owed by the National Office for Cereals (NAOF CER) (88 Mio CFA.F / \pm 0,3 Mio ECU/ under the 1982/1984 programmes and 71 Mio CFA.F / \pm 0,2 Mio ECU/ under the 1985 programme.

The use of counterpart funds

3.12. At the end of 1985, 700 Mio CFA.F (\pm 2,0 Mio ECU) were repaid to the NAOFCER with a view to purchasing local cereals. In March 1986, Burkina Faso requested the allocation of a further 500 Mio CFA.F (\pm 1,5 Mio ECU) for the purchase of local cereals. A measure to replace 1,54 Mio ECU decided on at the beginning of 1986 has a similar object. All of this, and in particular the 700 (\pm 2,0 Mio ECU) and 500 Mio CFA.F (\pm 1,5 Mio

ECU), may be seen as a disguised form of support for the NAOFCER, and the amount corresponds to the debt of 1 178 Mio ECU settled by the NAOFCER between the end of 1984 and the end of 1985.

3.13. Moreover, 669 Mio ECU were devoted to development projects, but there is a considerable balance of 5,25 Mio CFA.F ($\pm 1,5$ Mio ECU) which could be put to other uses than the payment of subsidies to NAOFCER, as referred to under paragraph 3.12. In particular, the text of the delivery agreements, which refers to development projects, should make it possible, where economically profitable, to finance investments in the industrial or transport sectors, especially if such investments indirectly benefit agriculture. Thus, the Court visited a project concerning the repairing of unmetalled tracks linking Aribinda to Dori via Gorom-Gorom, at a cost of 78 Mio CFA.F ($\pm 227\,000$ ECU), which were carried out in 1984/85. During the 1984/85 rainy season, the tracks in question, in particular those between Dori and Gorom-Gorom, were badly damaged once again. Considering the importance of this link with the North, the funds would have been more sensibly used had they once again been used for repairing these tracks.

Egypt

Opening the counterpart account

3.14. A single account has been opened at the central bank. It is an account financed by the Ministry of Supply and kept by the Ministry of Finance. This account receives the proceeds of the sale of the food aid received by this country, without any distinction being made between the donors.

3.15. One cannot fail to note the very long periods of time which elapse between the arrival of the Community food aid, its sale on the market, normally in the following three months, since Egypt has an average storage capacity of three months, and the period when the funds are actually credited to the account. Up to January 1986, almost none of the amounts corresponding to the deliveries made under the 1983, 1984 and 1985 programmes had been credited to the account. The funds corresponding to the 1983 and 1984 programmes were credited at the beginning of January 1986.

Financing the counterpart account

3.16. The value of the food aid delivered from 1978 (the first year in which counterpart refunds were instituted in Egypt) until the 1985 programme amounts to some 235,8 Mio ECU (average value at world market prices), about 189,3 Mio £E (at the March 1986 exchange rate: 1 ECU = 0,802 £E). The net sale value recognized by the Egyptian authorities for this food aid, after deductions, is about 63 Mio £E ($\pm 78,6$ Mio ECU), i.e. one third of the

initial value of the goods. The amounts that have actually been credited to the counterpart fund account are about 50,5 Mio £E (± 63 Mio ECU). The amounts received were smaller mainly because of the lengthy payment periods mentioned previously, but also because of unexplained differences between the values used and the amount of the transfers that were made. Apart from the low return, which resulted from anomalies in the payment of funds into the account, above all it was the low prices charged and the proportionally high transport and distribution costs which were responsible for such a large reduction in the counterpart fund receipts. On the other hand, no appreciable loss in value was noted due to damage or the requirement to distribute the goods received free of charge.

The use of counterpart funds

3.17. It was only very recently that funds actually started to be paid on a more regular basis into the counterpart account. The information supplied by the Egyptian authorities in this respect is so vague that at the present time it is impossible to break down the data entered under the debit items of the account into intended expenditure, expenditure agreed in principle, expenditure actually committed by the signing of the contracts or other similar commitments and expenditure which has been incurred and has resulted in payment. In fact, it would appear that, up to now, none of the projects listed as due to be financed from the counterpart funds has actually resulted in a payment being made, in other words, in the actual disbursement of funds by an Egyptian authority, for the benefit of a contractor or a person providing a service, after a service has been provided. In 91 % of cases, the recorded 'use' of counterpart funds appears to be just intended expenditure, whereas the expenditure which has actually been incurred and resulted in payments is of the order of 18,6 Mio £E ($\pm 23,2$ Mio ECU), i.e. 37 % of the available funds and, more significantly, 10 % of the initial value of the food aid. The debits recorded in the counterpart account appear to be mere book entries transferred between the different budget headings of the Egyptian ministries.

Supervision of the counterpart account

3.18. The information which the delegation has at its disposal is particularly inadequate. This may partly be explained by the complexity of the national administration system, since four ministries are involved in aid management, and this has led to a failure on the part of the authorities to honour their obligations. They have not forwarded the progress reports in the required form or within the prescribed time limits. The only data which can be considered to be in accordance with the agreements relates to the execution of the 1982 programme. For

subsequent programmes, the delegation only has access to incomplete and contradictory information, which it is impossible to compare, let alone check. Carrying out a check, for example, implies being able to ascertain the quantities shipped, find out the delivery price and assess whether the deductions were actually made. The delegation can only 'record' the figures which have been brought to its attention.

3.19. In recent years, the delegation has tried hard to improve its information and its control of the use of funds. The agreements negotiated with the authorities for the 1986 programme include new clauses which aim to clarify the conditions governing the calculation of the amounts to be paid into the funds and to limit the likelihood of improper deductions being made. The inclusion of such provisions is the first sign of a willingness on the part of the Commission to tighten up the conditions set out in delivery agreements for all recipient countries. However, this attitude is not likely to have any positive effects before 1988.

3.20. Of more immediate effect is the presence of a representative of the delegation on the interministerial committee responsible for implementing proposals for the utilization of counterpart funds. The Community is the only donor to benefit from such a privilege. This should enable it to find out which projects are listed and help it to exert a more direct influence on the selection of projects. It will also make it easier for the Community to carry out on-the-spot checks in relation to the execution of the projects financed, as it has already done on several occasions.

4. CONCLUSION

4.1. From an examination of the counterpart funds, it is clear that there are extreme discrepancies between the facts observed and what the Court, on the assumption of a

correct application of the delivery agreements, is entitled to expect:

- (a) the volume of resources recorded is, generally speaking, less, and, in many cases, much less, than the amount laid down in the agreements;
- (b) amounts recognized as due by the recipient states have not been paid;
- (c) the low rate of use of some of the resources credited to the counterpart funds raises doubts as to the actual possibility of implementing development projects or programmes in the rural and/or agri-foodstuffs sector.

4.2. Such a situation is due to a considerable extent, to the fact that the text of the delivery agreements is not suited to the circumstances. The Commission should re-examine certain provisions of these agreements, especially the definition of the amounts to be credited and the possibility of deducting certain expenses. As soon as the aid is granted, it should be possible to agree on the amount to be paid by the recipient. The Commission should also define the rôle of its delegations more precisely and encourage them to extend the delivery agreements by rules of execution which are negotiated locally and suited to local circumstances.

4.3. However, the reasons for the inadequate functioning of the counterpart funds system are perhaps more profound. It is extremely difficult to manage such a system efficiently. And more especially, in the States in question, the situation develops in such a way that it becomes impossible to prevent foodstuffs which were initially intended to be disposed of in return for due payment from in fact being disposed of free of charge or at very low prices. The lack of purchasing power, which is often combined with a shortage of the foodstuffs themselves, encourages increasing recourse to distribution of food free of charge. In such situations, the Commission should avoid being faced with a *fait accompli* and should maintain full control of the operations.

This report was adopted by the Court of Auditors in Luxembourg at its meeting of 26 and 27 November 1987.

For the Court of Auditors

Marcel MART

President

(1) OJ No L 352, 14. 12. 1982, p. 1.

(2) OJ No L 370, 30. 12. 1986, p. 1.

REPLIES OF THE COMMISSION

Preliminary remarks

The Commission shares some of the concerns of the Court as regards the management and operation of counterpart funds. Following discussions in a working group constituted last year to study the whole question of the management of counterpart funds, the Commission is presently in the process of revising the 'general conditions' document in order to better define the guidelines for the creation and use of counterpart funds.

The guidelines will reflect the experience gathered by the Commission since 1982, when the efforts aimed at the integration of food aid into the development process were given a new impetus. Since then there has been considerable improvement in a significant number of countries on both accountability and utilization of counterpart funds; in particular the quality of the information provided by beneficiary governments has much improved and is now an important criterion for renewal of annual food aid allocations.

In general both donors and beneficiary countries now come to recognize the economic value of food aid as a transfer of resources, as distinct from its value as a supply of additional food products. The new guidelines will put this development into concrete form as far as the Community's food aid is concerned.

Finally, it should be noted that the approach followed by the Commission as regards counterpart funds is similar to that of the other major bilateral food aid donors.

However, the Commission cannot accept the final conclusion of the Court's report, namely that lack of purchasing power in beneficiary countries tends to lead to the free (or very low-priced) distribution of aid intended for sale at market price

1. INTRODUCTION

The objectives and mechanism of counterpart funds

1.2 – 1.5. The only reference made in Community regulations to the objectives to be attributed to counterpart funds is that mentioned in point 1.2 paragraph (b) of the report, namely art. 2 paragraph 3 of the old framework regulation reproduced in art. 2 paragraph 5 of the new regulation. The report correctly states (point 1.4 paragraph (c) that the standard text of the general conditions of the official letter refers to 'the financing of one or more development projects in accordance with the procedures to be established between the country of destination and the Community'. The report goes on to say that the project or projects thus financed should, in accordance with Regulation 3331/82, give priority to the promotion of food production in the recipient country. However, it should be made clear that the regulation specifies that where aid is granted conditionally upon the implementation of development projects (which may be financed from counterpart funds) priority shall be given to projects which promote the production of food. This is not the same as saying that all such projects must have the promotion of food production as a priority. Indeed, the only other guideline for the uses to which counterpart funds may be put appears in Article 35 paragraph 1 (b) of the third Lomé Convention; in the previous Conventions (viz. until 1985) no reference was included. In the relevant passage there is some linguistic ambiguity between the French and English texts. However French being the language in which the text of the Convention was drafted, the French text may be taken to reflect more accurately the wishes of the contracting parties. Article 35 paragraph 1 (b) of the French text reads: 'b) lorsque les produits fournis au titre de l'aide alimentaire sont vendus, ils doivent l'être à un prix qui ne désorganise pas le marché mondial. Les fonds de contrepartie qui en résultent sont utilisés pour financer la mise en œuvre et/ou le fonctionnement de projets ou de programmes touchant en priorité le développement rural'.

This situation has led to the onus being put on the agreements made between the beneficiary country and the Community (represented by its delegation) as regards the definition of the use to be made of counterpart funds.

In assessing the objectives to be pursued by counterpart funds, those set out for food aid itself have not unnaturally been taken into consideration. Indeed the Court itself does this in its report (point 1.2.(a)).

However, there would seem to be no grounds for excluding the other two objectives of art. 2 paragraph 1 of the old framework regulation, in particular the reference 'to help in emergencies'. In point 2.22 of its report the Court appears to consider such operations as lying outside the scope of counterpart funds. Furthermore the new framework regulation contains two new objectives in Article 2 paragraph 1 (to promote food security and to support efforts by recipient countries to improve their food production) as well as a new paragraph 2 stipulating that 'food aid shall be integrated as thoroughly as possible into development policies, and food strategies of the countries concerned'.

It is therefore reasonable to assume that, in so far as it considers that the objectives assigned to food aid should implicitly be extended to the use of counterpart funds, the Court can accept that the new formulation of the framework regulation permits a wider use of counterpart funds than it has hitherto believed permissible. For example the co-financing of units for the coordination of a country's food strategy (point 2.22) aims expressly at such objectives.

2. THE RESULTS OF THE SURVEY BY QUESTIONNAIRE

Opening the counterpart account

2.1 – 2.6. It is true that the ability to accumulate interest on deposits and to remain separate from the general budget of the beneficiary country makes the opening of an account with a financial institution other than the central bank an attractive proposition in many cases. The revised text of the general conditions (mentioned in the preface above) provides for this possibility.

Financing the counterpart account

2.7 – 2.17. The Commission cannot accept there is 'an irrepressible tendency' (point 2.11) towards free or low-priced distribution as a result of lack of purchasing power. Where circumstances in a beneficiary country change, notably in cases where emergency needs arise, it is only prudent that the possibility should exist to permit, by common agreement, the free distribution of aid originally intended for sale. In the case of Mauritania this agreement was given with respect to the transfer of 1983 and 1985 cereals aid in order to provide relief for drought victims. Part of the 1984 cereals allocation intended for sale was indeed used for free distribution without the Commission's agreement. This coincided with a period of political instability culminating in the coup d'état in December 1984. Control of counterpart funds in Angola prior to its signature of the Lomé Convention in 1985 was rendered considerably more difficult by the absence of any delegation. The Commission is aware that some 5 400 T of the 1984 cereals allocation of 20 000 T were not sold but were given, without prior agreement for free distribution to refugees from the civil war.

The Court is correct in asserting that the basis for the calculation of counterpart funds, as presently set down in the general conditions of the official letter, is inadequately defined. No explicit provision is made for the deduction of costs (e.g. transport, distribution) from the gross value of sales to be allocated to the counterpart fund. Moreover the sale price itself is sometimes hard to specify precisely and is frequently an administered/subsidized price set by the government.

This situation led the Commission when revising the general conditions of the official letter to much the same conclusions as those of the Court. It seems logical that the general principle should be to credit the counterpart fund with the economic value of the gift made, viz. the actual f.o.b., c.i.f. or f.a.d. price (depending upon the terms of the allocation) which represents the saving made to the beneficiary country's balance of payments. This approach has the merit of clarity and is widely shared by other donors.

The Court appears to accept (point 2.17) the principle that the price retained for the purposes of calculating the sum to be credited to the counterpart fund may indeed be different from the actual sale price (although it should be noted in passing that the former cannot of itself disturb local production). This is consistent with the Commission's thinking, namely that the former should reflect the value of the allocation made whereas the latter is principally a question of the beneficiary government's food policy.

It can be agreed that customs duties should not be levied on the suppliers of Community food aid (point 2.15a) since this leads to allowance for import duties simply being included in the tenders and so passed on to the Community. It is clear, however, that where domestic prices are higher than world prices, the beneficiary government may require duty to be paid by the agency in receipt of the aid in order that local prices should not be disturbed. In the same way that countries with low price food policies are required to bear the cost of subsidization through the sum transferred to the counterpart fund, so it is only reasonable that countries with high price food policies should normally be allowed to retain taxes and duties received as a result of this policy as a budgetary resource.

The use of counterpart funds

2.18 – 2.24. The system of dual signature for counterpart fund accounts (points 2.18 and 2.19) indeed has strengths and weaknesses. In addition to the points made in the report there is the further advantage that the use of a dual signature enables the management and control of counterpart funds to be aligned more closely with those of EDF funds.

For the reasons developed in the introduction (see above) the Commission insists that the use of counterpart funds to meet the distribution costs of emergency aid allocations, or to co-finance food policy units and intervention agencies (points 2.21-2.23) is entirely consistent with the objectives set down in Community regulations. However, it agrees with the Court that great care must be taken to ensure that operational problems, as in, for example, cases where the replenishment of working capital has been neglected, do not occur

Monitoring of counterpart funds

2.25 – 2.26. The Commission shares the positions of the Court and instructions of the sort mentioned have already been drafted for transmission with the revised official letter.

3. EXAMINATION OF COUNTERPART ACCOUNTS IN NIGER, BURKINA FASO AND EGYPT

Niger

Financing the counterpart account

3.2 – 3.5. Regarding the assertion that 'the OPFN acknowledges that it still has to pay into the account an amount totalling 780 Mio CFA.F (approximately 2,3 Mio ECU)', that sum has been added to the OPFN's capital. The move represents an initial step in the restructuring of the OPFN, involving the Caisse Centrale de Coopération Économique (CCE), which was put in hand in 1985. The full restructuring plan has now been drawn up and awaits the decision of the Niger Government, which should be forthcoming by the end of the year.

Burkina Faso

Opening the counterpart account

3.8. The first food aid counterpart funds account, with the Treasury, had a balance of 130 196 750 CFA.F, which was used for repair of the tracks between Aribinda, Gorom-Gorom and Dori; the repairs cost a total of 162 041 680 CFA.F.

The food aid counterpart account with the Treasury (a/c CET 30 157) is therefore closed.

3.9 – 3.10. Separate accounts have been kept for all operations using the IBTIA food aid counterpart funds account, enabling them to be properly monitored.

Moneys not needed in the short term are placed in a term account, in accordance with the principles of sound financial management.

The use of counterpart funds

3.12 – 3.13. Support for NACFCER to help it to channel cereals from areas in surplus to towns and deficit areas is in line with the organization's *raison d'être*. The Commission considers the mobilization of local resources to be preferable to the distribution of imported aid.

A decision has already been taken to allocate the balance of the counterpart fund account to a rice cultivation project. Studies are well advanced and the project should get under way shortly. The use of this money to finance purchase operations is a way of mobilizing local resources and avoiding unnecessary imports. The balance of the counterpart funds can be used for the Comoé rice growing project, currently at the study stage.

Egypt

3.15. At the urging of the Commission Delegation in Cairo the Egyptian authorities have finally agreed from this year onwards to pay counterpart funds, within six months of receipt of the aid, into a special account in the name of the Ministry of Agriculture. The account requires two

signatures, one of them that of the head of the Delegation. The Delegation will also be represented on the committee which is to decide how the money will be used, referred to by the Court at 3.21.

3.16. The Egyptian authorities have accepted the new, stricter conditions for food aid under the 1987 programme. One of these conditions is that between now and 1990 the basis on which counterpart funds are calculated will gradually be aligned on the world market price of the products supplied.

3.17. Although the Egyptian authorities have not provided details, some agricultural projects have nevertheless been financed using counterpart funds. In accounting terms the drawings from the special account may look like mere book entries transferred between the budget headings for various Egyptian ministries, but we feel it is important that the increase in budget appropriations has enabled projects to be financed which contribute to the development of Egyptian agriculture. Obviously, things are different with operations or projects financed under the financial protocol, when administration of the funds can be directly supervised by the Commission.

3.19. The Commission hopes that the new procedures worked out with the Egyptian authorities, cutting the financed ministry out of the banking arrangements and specifying a dual signature for the special account, will allow more rapid use and better monitoring of the counterpart funds and satisfactory implementation of the development projects or programmes financed by them.

The Commission and the delegations will in particular spare no effort to improve the operation of counterpart funds deriving from aid granted in more recent years.
