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from: Secretary-General of the European Commission,
signed by Mr Jordi AYET PUIGARNAU, Director

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to: Mr Javier SOLANA, Secretary-General/High Representative

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the Commission to the Council and the European Parliament on strengthening
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Delegations will find attached Commission document SEC(2006) 1512.

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COMMISSION OF THE EUROPEAN COMMUNITIES

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COMMISSION STAFF WORKING DOCUMENT

Accompanying the :

**COMMUNICATION FROM THE COMMISSION TO THE COUNCIL AND THE
EUROPEAN PARLIAMENT**

ON STRENGTHENING THE EUROPEAN NEIGHBOURHOOD POLICY

Sectoral Progress Report

{COM(2006)726 final}

Trade and regulatory reform

Transport, energy, the information society, the environment and research

The detailed work of reform, modernisation and transition, whether in the field of trade, customs or the economic regulatory framework, or in sectors such as transport, energy and the environment, is at the very core of building a modern and well-governed economy. Yet this detailed work is easily lost to sight, by virtue of its often technical character. In addition to the short overview provided in the Overall Assessment, it appears useful to present a more comprehensive view of the range of work carried out in these different areas by ENP partners during the last eighteen months.

In the field of trade and customs:

Progress was made in the area of **trade liberalisation** by launching negotiations on agricultural, processed agricultural and fishery products with the Mediterranean partners, and conducting preparatory work for the negotiation of a deep Free Trade Agreement with Ukraine and for the granting of Autonomous Trade Preferences (ATP) to Moldova. Technical discussions with Mediterranean ENP partners on dispute settlement mechanisms also started in 2006.

The Agadir agreement for the establishment of a free trade zone among four Mediterranean nations, and the upgraded Agreement between Israel and Jordan, came into force in 2006.

In the field of **customs**, ENP partner countries continued their efforts to modernise and streamline the relevant legislation, and strengthening administrative and operational capacities, in line with EU and international standards, as well as to pursue the fight against fraud and internal corruption. Further efforts are needed to reinforce customs control of counterfeit and pirated goods. There has also been enhanced cooperation on confidence-building issues such as the Moldova-Ukraine customs agreement. Most partners have adopted the Pan-Euro-Mediterranean Protocol on Cumulation of **Origin**, allowing for diagonal cumulation within the region.

The approximation of legislation on **standards, technical regulations and conformity assessment** is a major ambition of the ENP. It will ultimately lead to the conclusion of bilateral agreements on conformity assessment between the EC and partner countries (Agreements on Conformity Assessment and Acceptance of Industrial Products - ACAAs) which have the effect of facilitating access to the EC internal market for industrial products from partner countries and vice versa without any additional testing and conformity assessment procedures. Overall, good progress has been made in this sector in that all Southern partners and Ukraine have confirmed their commitment to negotiate an ACAA and have selected the priority sectors to be covered. To that end, progressive alignment with EC legislation and administrative structures is taking place. Challenges remain in building the necessary administrative, legal and technical capacity to manage and enforce the legislation.

Southern ENP partners have started negotiations with the EC and its Member States towards a free trade agreement on liberalisation of **services and establishment**.

Regarding **sanitary and phyto-sanitary** issues, modest progress was made by most partners. Jordan took the decision to converge with the relevant EU *acquis* over the medium term. A first-ever overall assessment mission by the EC Food and Veterinary Office to an ENP country took place in Ukraine. Other examples of progress include Moldovan and Tunisian efforts towards an animal identification and traceability system. Partners also enhanced their preparedness in relation to the avian influenza crisis.

In the regulatory field:

Many ENP partners are still hesitant about implementing fundamental reforms to modernise their **company law**, to strengthen corporate governance, increase the transparency of financial information, protect minority investors and improve companies' internal controls. Tunisia has made substantial progress here, and Jordan is also considering important reforms.

No real progress was yet made to increase transparency in the field of state aid, with the exception of Ukraine, which has reported that it is preparing legislation in this field.

Improving the **investment climate** is a fundamental priority in all ENP countries. Reforms vary in scope and ambition, depending on local circumstances and existing legislative frameworks. However, most countries are engaged in an effort to simplify administrative procedures for setting up a business, reducing the number of permits and licenses for operating a company and setting-up one-stop-shops for business registrations. Moldova, through a so-called "guillotine law", has taken very strong steps to reduce and simplify required business permits and licences. Morocco has made strong progress in improving the business environment.

In the area of **taxation**, most partner countries have launched or continued the reform of national tax legislation and tax administration in line with EU and international standards. However, much remains to be done in several countries. Most countries continued to widen the network of bilateral treaties on the avoidance of double taxation with EU Member States. Much needs to be done also to achieve results on the implementation from all countries on the principles of the code of conduct for business taxation.

Many countries have continued the process of modernising their legislative framework on **intellectual property rights**, (notably Morocco and Ukraine) and have increased efforts to seize pirated and counterfeited goods. Much remains to be done to increase protection of right-holders, increase administrative capacity for enforcement, and strengthen the judicial system's ability to handle complex issues in this field.

On **financial services**, most ENP partners are upgrading their regulatory framework and administrative capacity, at different rates and with differing levels of ambition. New legislation is being proposed with a view to aligning with the Basle core principles for effective banking supervision. Progress is being made in building up independent

supervisory authorities (which remains a priority in many partner countries), while securities markets and non-bank financial institutions need to be further strengthened.

All ENP countries are actively engaged in a process of **public finances management reform**, involving in particular the overhaul of their public internal financial control system. In most cases, the reform objectives are to improve the efficiency of public finances management, increase managerial accountability and reduce the level of bureaucratic ex-ante financial control. At the same time, reforms tend to promote internal audit geared to analysis and improvement control systems while focusing external audit on performance assessments. Ukraine and Moldova have ambitious programmes much in line with the EU model; Morocco, Tunisia and Jordan are also engaged in reforms but they are less ambitious in terms of approximation.

Most ENP partners continue to be prudent in their policies on liberalisation of **movements of capital and payments**. This is largely related to the need for further consolidation of both the macro-economic situation and the domestic financial sectors. Tunisia is pursuing a prudent strategy of opening its capital account. Jordan and Morocco have not made progress. Restrictions for non-residents still remain in Ukraine.

Reforms in the area of **public procurement** are crucial in improving public governance and the efficiency of public spending. In this area, progress has been limited, and most ENP partners remain far from EU standards, in terms of transparency of procedures, right of appeal and remedies system, the disclosure of information and elimination of preferences granted to nationals. In the Ukraine, recent policy changes have even led to the deterioration of transparency, access to information and administrative capacity.

Some ENP countries (Morocco, Israel) are taking a keen interest in developing cooperation with the EU on **consumer protection**. Israel has expressed an interest in participating in EU's Rapid Alert System for Non Food products (RAPEX)

Partners pursued **health** reform and will do so in the next years. Better health contributes to poverty reduction and socio-economic development. HIV/AIDS prevalence is serious in the 'Eastern' part of the ENP region, notably the Ukraine. This country has begun to participate in the Commission's HIV/AIDS Think Tank.

All Mediterranean partners have launched the Euro-Mediterranean Charter for **Enterprise** process, and are committed to its implementation. In most countries, the Charter has also stimulated discussions between the private and public sectors, and proved instrumental in setting up permanent networks of stakeholders and in improving inter-ministerial coordination. This is an important result, although private sector participation in this process should be further enhanced. Important challenges remain in such areas as administrative simplification, entrepreneurship education, and access to finance. In Ukraine, on the other hand, there has been little progress in taking forward the adoption or implementation of the Charter for Small Enterprises.

In the field of transport:

Good progress has been made in that most countries have adopted long-term **national transport strategies** and have started reform processes separating operational and commercial functions with a view to increasing the competitiveness of the various transport modes.

Most progress has been made in the **aviation sector**, where the sector generally has started to be liberalised. Stricter security standards have been introduced, ground-handling services have been liberalised and most countries have established civil aviation authorities. Morocco has proceeded the furthest in developing aviation relations with the EU.

The **road and rail sectors** present an important reform challenge. Measures to increase road safety are starting to take effect, while the sector tends to suffer from inefficient small-scale operations and ageing fleets. Rail restructuring is generally being addressed, but is progressing slowly in many cases.

Maritime safety standards are more difficult to meet for some countries, especially where the fleet is ageing, as in Ukraine. Most partner countries have however begun port sector reforms, with particular progress in Morocco, Tunisia and Israel.

The EU has reached agreements with Ukraine, Israel and Morocco on participation in the **Galileo** programme.

A lot of progress was made on **regional transport cooperation**. The high-level group on the extension of the trans-European network to neighbouring countries and regions was established and submitted its report to the Commission. The TRACECA and the Baku ministerial conferences on 2 and 3 May 2006 in Sofia, adopted the TRACECA Strategy for the horizon of 2015. Furthermore, a Blue Paper for transport strategy in Mediterranean was adopted and a first Euro-mediterranean ministerial conference for transport was held in December 2005.

In the energy sector:

Energy cooperation with ENP countries (and their neighbours), including both producer and transit countries, is crucial for the EU's energy security and has been significantly enhanced. A Memorandum of Understanding (MoU) on Energy with Ukraine was signed at the 2005 EU-Ukraine Summit, while MoUs have been signed or are being developed with other strategic energy partners covered by the ENP (Azerbaijan and Algeria). The EU stepped up bilateral dialogue, including with Moldova, as well as regional cooperation through the Euro-Mediterranean Energy Forum and the Baku energy initiative for the Black Sea/Caspian area.

Network projects progressed and will contribute – once finalised – to the EU's energy security. Ukraine confirmed its intention to use the Odessa-Brody oil pipeline in the South-North direction, Jordan pursued the construction of the Arab gas pipeline, Tunisia

is expanding the gas pipeline to Italy and Morocco is reinforcing the electricity interconnections with Spain.

Following a gas-price dispute with Gazprom, eastern partners accelerated the move towards **market prices**. Many partners have taken modest steps towards market opening, enhancing energy efficiency and the promotion of the use of renewable energy sources, but more efforts are required.

For Ukraine, continued improvement of **nuclear safety** and further implementation of the Chernobyl shelter project constitute additional tasks in the energy sector.

With the Commission's assistance, the Euro-Mashrek Gas Cooperation Centre was established with the participation of Egypt, Jordan, Lebanon and Syria and the preparations are ongoing for the project of the integration of the Maghreb electricity market. A financing agreement was signed, with the support of the Commission, in December 2005 to implement a three-year **Israeli-Palestinian Energy Cooperation Programme** including the establishment of a joint energy office. Implementation of this initiative has been suspended in the light of the current situation in the region.

As regards the development of the information society:

Several partner countries have adopted **national strategies** promoting the use of information society applications and have decided on the preparation of the related legal framework.

All partner countries except Israel have set up independent national **regulatory agencies** although there is usually a need to increase their efficiency by providing training as well as additional human and financial resources.

All partner countries have liberalised their **markets for mobile telephony** and the fixed telephony market is being opened up for competition in Jordan, Israel and Morocco; licences for third-generation mobile communications (3G) have been awarded.

In the field of the environment:

Progress has been limited, reflecting the vast scale of the challenges in this sector, and can only be incremental. Greater administrative and **implementation capacity**, coupled with enhanced resources, is essential, but is lacking in most cases.

Good progress is being made in implementing international climate change commitments. Most partners have continued to adopt and establish the necessary procedures and structures, together with concrete investment projects, to promote the use of the flexible mechanisms of the **Kyoto Protocol**. It is important that these countries also are engaged in international discussions on post-2012 climate action, which will be an important part of EU external policy in the next few years.

A number of partner countries have also taken steps to review (Jordan, Ukraine) and implement (Israel, Morocco, Tunisia) their overall **environment strategies** and action plans to promote a more strategic and targeted approach to environment protection. Jordan has also reviewed its framework legislation, and Moldova has prepared an inventory of existing legislation.

Some progress can be noted in the adoption and implementation of **issue-specific legislation**, e.g. on environmental impact assessment in Tunisia and on the preparation of specific programmes and plans, most often in the field of water, in Ukraine and Morocco. In addition to water and a number of other environmental concerns, waste management is a particularly serious challenge for the majority of partners, with national strategies under preparation in Morocco, Tunisia and Ukraine.

Certain partners have taken steps to enhance public **access to environmental information** and to promote participation in environment decision-making, in particular in Israel, Moldova, Morocco and Ukraine.

With some exceptions, partner countries have ratified many international and regional environmental **conventions and protocols**, and participate in various regional initiatives. However, implementation of these commitments remains a major challenge in most cases.

In the area of research and innovation:

A number of partner countries have reviewed their **research and innovation policies** and restructured their **research systems**. The transfer of knowledge between public research organisations and industry, and the link between research and innovation is often an important element of this policy review. Tunisia and Moldova have set up special agencies to promote this transfer and have increased their research budgets. Partners are seeking to increase their participation in the Community R&D Framework Programme.