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

**Fourth Annual Report 2009 on the implementation of Community assistance under
Council Regulation (EC) No 389/2006 of 27 February 2006 establishing an instrument of
financial support for encouraging the economic development of the Turkish Cypriot
community**

1. INTRODUCTION

Council Regulation (EC) No 389/2006 establishing an instrument of financial support for encouraging the economic development of the Turkish Cypriot community¹ (hereafter the "Aid Regulation") was adopted on 27 February 2006. On the basis of this regulation, €259 million was allocated from the 2006 Community budget.

This fourth report covers the period from 1 January until 31 December 2009.

2. PROGRAMMING OF THE ASSISTANCE

Under the 2009 budget € 2.5 million was programmed for scholarships, schools and technical assistance².

3. IMPLEMENTATION MECHANISMS

The European Commission is responsible for administering the assistance primarily through centralised management; some projects are in joint management with UNDP (United Nations Development Programme). The programme is implemented in an EU Member State in an area that is not under the effective control of that Member State's Government and where the application of the EU *acquis* is suspended.

A Programme Support Team was set up in 2006 to implement the programme within the Commission's Directorate-General for Enlargement (DG Enlargement). Working on a long-term mission in Cyprus, it uses the EU Programme Support Office (EUPSO) established in September 2006, located in the northern part of Nicosia. This office provides a venue for meetings and seminars with Turkish Cypriot stakeholders. It also allows direct supervision of contractors. Office logistics continue to be provided by a private contractor (Deutsche Gesellschaft für Technische Zusammenarbeit - GTZ) under a contract running until June 2012. The Representation of the Commission in Cyprus also provides a venue for meetings and seminars.

During the reporting period, staffing of the Programme Team slightly increased. By December 2009 it comprised 41 staff including 3 Commission officials, 26 contract agents and 12 local staff provided by GTZ for administrative and logistical support.

4. IMPLEMENTATION DURING THE REPORTING PERIOD

4.1. General overview

The Commission implements the programme in a unique political, legal and diplomatic context. *Ad hoc* arrangements are needed to allow the Commission to

¹ OJ L65, 7.3.2006, p.5.

² Commission Decision n°C(2009)7569 of 8 October 2009.

implement the programme while respecting the principles of sound financial management.

Generally in EU-funded aid programmes, a Financing Agreement with the Government of the beneficiary country establishes the legal framework under which the assistance is implemented, regulating issues such as taxation and work and residence permits. No such agreement exists for this programme. Therefore, the Commission has to rely on what it understands to be the rules and conditions currently applicable locally. The possibilities of enforcement might therefore be difficult and might change during the lifetime of a contract. The lack of a Financing Agreement means that the Commission, in entering into contractual arrangement with its contractors, takes on more risks than it would normally encounter.

Because of the political context, enforcement of recovery orders for amounts to be recovered from Turkish Cypriot entities (in case of non-compliance with terms of contract) may be difficult. The Commission has adopted measures to mitigate this risk including intensive monitoring and support, revised payment conditions, linking advance payments with proof of signed procurement contracts and the extensive use of bank guarantees.

The Commission relies on the support of the Turkish Cypriot community to make this programme a success and in particular to ensure its sustainability in the long-term. Turkish Cypriot experts were involved in drawing up technical specifications and terms of reference and took part in tender evaluation panels. Turkish Cypriot beneficiaries play a key role in project steering committees.

In the year 2009, the bulk of the €259 million allocation was contracted bringing the overall contracting rate to 99% based on 880 separate contracts.

€10 million from savings in contracting and funds earmarked for two projects that could not proceed were reallocated to water infrastructure, preparation to implement the acquis and SME support.

Sustainability, in particular with regard to infrastructure projects, remains a matter of concern.

Property issues were addressed for all large scale infrastructure projects, primarily by locating projects on public land.

There was a political change in the northern part of Cyprus in April 2009 as a result of the National Unity Party (UBP) prevailing in the "parliamentary" elections.

4.2. Progress by objectives

The overall objective of the Aid Programme is to facilitate the reunification of Cyprus by encouraging the economic development of the Turkish Cypriot community with particular emphasis on the economic integration of the island, on improving contacts between the two communities and with the EU, and on preparation of the implementation of the EU law.

4.2.1. *Objective 1: Developing and restructuring of infrastructure*

The Programme Support Team tendered out and contracted €72.6 million of works contracts for **water/wastewater infrastructure** projects in 2009 bringing the total allocation for the water sector to around €84 million. The main works to be funded were new sewerage networks and wastewater treatment plants in Famagusta and Morphou/Güzelyurt, and a seawater desalination plant at Sirianokhori/Kümkooy. The latter contract was signed with a suspensive clause to allow time to secure from the Turkish Cypriot leadership adequate assurance firstly of free and unrestricted access to the construction site and secondly of their assistance for smooth, efficient and effective implementation. A contribution agreement was signed with UNDP for the co-financing of the new bi-communal wastewater treatment plant at Mia Milia/Haspolat. Other contracts include the replacement of ageing water distribution pipes and the supply of equipment for the local water testing laboratory.

Underperformance of the design consultant meant that the work to finalise contract documents, invite and evaluate tenders, finalise budgets and negotiate contracts (including with UNDP for Nicosia wastewater treatment plant) for water sector projects was effectively compressed into less than eight months up to the contracting deadline. In addition, the team supervised finalisation of designs for wastewater investment projects for Nicosia, Kyrenia and Lefke.

On **nature protection**, a first cycle of training was completed in accordance with the training strategy. Public information meetings were held for all six potential Natura 2000 areas. Draft management plans were prepared for five of the six potential Natura 2000 areas. The scope of the project was extended to cover the preparation of a management plan for a seventh site. Contracts for supply of equipment as well as for construction of facilities for management and protection had been concluded for €3.5 million.

In the **solid waste** sector, the main activities focused on tender dossier preparation and tendering of four works and six supply contracts. Nine of these ten tenders were successfully completed and contracts were signed. The tenth contract will be implemented by UNDP. Work on the three main construction contracts linked to the rehabilitation of the old waste dumpsite near Kato Dhikomo has been suspended until all property issues are resolved. This will cause slippage in implementation of at least six months.

The extensive site investigations, feasibility study and conceptual designs for the rehabilitation of the former **mining and ore processing** sites in the Lefke/Lefka region were finalised in 2009. Remediation solutions for that area minimising the impact on the environment and human health were identified. Further works there depend on decisions with regard to the future development of the area as well as the availability of financing.

In the **energy** sector, savings allowed for additional electricity meters to be procured in 2009. A Supervisory Control and Data Acquisition (SCADA) system was contracted that will allow real-time monitoring and control of the electricity network, with specifications that ensure compatibility and interoperability with the SCADA system currently in place in the government-controlled areas. A contract was concluded for a pilot **solar power plant** to provide in excess of 1 MW of power

output capacity. Additionally, a customer care system, consisting of the software to be integrated into and/or linked to the existing customer data system of the electrical utility company and the related hardware as well as a pollution control and weather/wind monitoring system, to monitor the emissions of the power plants in the northern part of Cyprus and to establish their impact on the environment, was contracted in 2009.

The main **telecommunications** investment contract will upgrade and replace the current network by a modern internet-based backbone infrastructure and greatly simplify the integration of telecommunications systems across the whole island. Technical assistance was contracted in 2008 to help the Turkish Cypriot community manage the sector according to EU standards and international best practice and to conduct a comprehensive training programme in view of the upgrading of the system. This contract has been extended to ensure the continuity of support for the sector despite delays in the reform process.

The **traffic safety** programme management contract supported contracting of the programme's components. The technical assistance for creating an effective accident information database and data collection system to strengthen the knowledge of traffic incidents started in early 2009, with the supply component being contracted towards the end of the year. The consultant for the development of a traffic operations plan for local communities also started his activity in 2009. Most of the contracts were signed towards the end of 2009 and activities will start in 2010. This was the case for the technical assistance and the supply component for the improvement of the vehicle inspections programme, the assistance for the improvement of the drivers licensing procedure as well as the traffic safety education campaign to promote traffic safety awareness and the development of a highway plan to address the current and future mobility needs. The project aiming at the elimination of traffic accident "black spots" was transferred to the UNDP for contracting and implementation.

4.2.2. *Objective 2: Promoting social and economic development*

The four technical assistance teams (Rural Development Support Team, Animal Husbandry, Crop Husbandry, Programme Management Unit), funded under the **Rural Development Sector Programme** have assisted the Commission in launching and evaluating several grant schemes. They delivered targeted training and technical assistance to farmers, veterinarians, and rural development experts, central and local stakeholders. Within the rural development grant scheme "Improving agricultural production" 142 contracts for a total value of almost €5 million were signed. Under the grant scheme "Supporting rural enterprise" 47 grants were awarded for a value of €3.3 million. Within the two grant schemes "Community development through Village Initiatives" 37 contracts for a total value of almost €8 million were contracted. In addition 10 supply contracts for veterinary laboratories and crop husbandry were signed for over €2 million.

With regard to the project **Upgrading of Urban and Local infrastructure** implemented in joint management with UNDP, 2009 saw the completion of the EU-funded restoration of the Bedestan building, in the northern part of the walled city of Nicosia. The study and design for this restoration received a 2009 Europa Nostra Award in the research category. Following the decision of the Leaders of the two

communities in Cyprus, UNDP completed the feasibility study for the opening of a seventh crossing point linking the villages of Kato Pyrgos/Asagi Pirgo and Yeşilirmak/Limnitis. The EU funded the feasibility study and earmarked €2.5 million for the works.

44 grants for a total value of almost € 1.6 million were awarded to local **schools** under the second and third call for proposals finalised in 2009. Projects included the provision of equipment (IT equipment, language labs, etc.) and related training as well as in some cases study visits abroad. Technical assistance was provided for the ongoing reform of the primary and secondary education sector. Supply contracts have been signed for the provision of specialised equipment to vocational schools.

To support **life-long learning, social inclusion and active labour market** measures, 21 grants were awarded to SMEs, chambers and other training organisations under the second and third call for a total value of almost €1 million. Technical assistance was provided for the development and promotion of vocational education and training systems, life-long learning and active labour market measures, including study visits to Germany and Malta.

The € 9 million project "**Micro and small enterprise loan programme**" could not go ahead due to difficulties in reaching agreement with *Kreditanstalt für Wiederaufbau* (KfW) in the special conditions prevailing in the northern part of Cyprus. Funds were reallocated in particular to projects supporting private sector development.

Concerning the support for **SMEs**, two grant programmes were launched that led to 33 contracts worth €4.5 million. Additionally a technical assistance project (€2.7 million) aiming at *Mainstream institutions and actions in the field of economic and ICT development*, was contracted during the reporting period.

4.2.3. *Objective 3: Fostering reconciliation, confidence building measures, and support to civil society*

Reconciliation, confidence building measures and support to civil society focused primarily on strengthening civil society organizations.

€4.8 million was awarded to 44 projects under three grant schemes called **Cypriot Civil Society in Action**. The Civil Society Support Team (technical assistance team) provided guidance and support to applicants organising training for civil society organisations.

€2 million was provided to the **Committee of Missing Persons (CMP)**. Together with an earlier grant of €1.5 million, the EU is the largest single donor to this bi-communal project.

Demining entered its final stage; the whole buffer zone is expected to be declared mine-free by April 2011. An additional EU contribution of € 2.5 million has been signed to ensure co-financing until the end of the project together with an allocation of a similar amount from the Republic of Cyprus.

The project **Academy of Political Studies**, implemented by the Council of Europe, focused on developing a common understanding among young Cypriot leaders on

key issues for the future of the island within an integrated Europe. The selected group of young leaders from both sides of the island participated in 3 seminars.

4.2.4. *Objective 4: Bringing the Turkish Cypriot community closer to the European Union*

For the academic year 2009/10, the third year of the Community **Scholarship Programme**, a total of 203 scholarships (121 graduates, 27 undergraduates, 55 teachers) was granted. Students and teachers were free to choose study programmes, although preference was given to some areas (Economics, Law, European studies, all Engineering fields, Public Administration, Public Finance, etc) where there is a lack of skilled professionals in the Turkish Cypriot community. Host countries were the United Kingdom, the Netherlands, France, Belgium, Germany, Italy, Spain, Sweden, Lithuania, Estonia, Austria, Portugal and Greece.

€0.8 million was awarded to 15 projects under the two grant schemes for **Promotion of Youth Exchanges and other People-to-People Contacts**. The objective is to help Turkish Cypriots improve their understanding of European values, experiences and multi-cultural traditions. The absorption of grants under this project was lower than expected.

The **InfoPoint** was set up and started its activities in June 2009 by providing information about the EU, in particular the aid programme, to the Turkish Cypriot community and by organising visibility events in cooperation with the European Commission Representation in Cyprus.

4.2.5. *Objective 5: Preparing the Turkish Cypriot community to introduce and implement the *acquis communautaire**

The European Commission's Technical Assistance Information Exchange (TAIEX) instrument has been used as the main tool for delivering assistance in this area. In 2009, 237 technical assistance activities such as training courses, workshops or seminars were organised for the Turkish Cypriots through the TAIEX programme, mobilising EU Member State experts on 449 occasions.

Activities mostly focused on developing the **Programme for the Future Application of the Acquis (PFAA)**. The PFAA provides a clear framework for planning and delivering technical assistance and training in order to help Turkish Cypriots prepare for the lifting of the suspension of the *acquis* after reunification. Assistance was provided in 13 sectors of the PFAA such as agriculture, anti-money laundering, environment, statistics and health and consumer protection³ Intensive efforts were made to adapt the TAIEX instrument to the specific context and needs of the Turkish Cypriot community. The aim was to move to more structured medium-term and project-based assistance as a more stable basis for achieving the programme's objectives. By the end of the year, following a consultation exercise with all EU Member States, TAIEX selected some 70 EU member state experts to help Turkish Cypriots to implement medium-term projects.

³ Full list of 13 active PFAA sectors: Free Movement of Capital; Public Procurement; Company Law; Competition Policy; Financial Control; Financial Services; Agriculture and Rural Development; Food Safety, Veterinary and Phytosanitary Policy; Transport; Statistics; Social Policy and Employment; Environment; Consumer and Health Protection

TAIEX also provided training on the preparation of legal texts aligned with the *acquis* for the purpose of these being immediately applicable upon the entry into force of a comprehensive settlement of the Cyprus problem. Similarly, linked to the future management of EU funds, training has been given in the area of **public expenditure management**.

Support was provided to the development of **trade across the Green Line**. EU Member State experts were continuously mobilised through TAIEX to carry out veterinary and phytosanitary nature inspections of potatoes and fish.

To ensure sufficient finance was in place for the continuity of TAIEX assistance throughout 2010, and the increased need for assistance in the event of a settlement, a further €5.5 million was reallocated to the TAIEX instrument. This brought the total budget for such technical assistance since 2007 to €14.5 million of which € 8.3 million had been committed to specific activities by the end of 2009.

4.2.6. *Unallocated Technical Assistance and Programme Reserve Facility*

The Programme Reserve Facility was used for the further support to the CMP (€ 2 million) and demining (€ 1.5 million)⁴. The unallocated Technical Assistance reserve (€1.2 million) was used to cover TAIEX activities.

4.2.7. *Financial assistance to cover administrative expenditure under Article 4(3) of the aid regulation*

A total of €18.65 million (i.e. 7.2% of the overall financial allocation) was earmarked for the programme implementation to cover costs of staff involved (up to €9.65 million) as well as wider technical assistance activities (€9 million). A €1 million Trust Fund was agreed with the World Bank to carry out studies within an "Economic analysis programme for growth and sustainable development".

From 2010 staff costs will be financed from the general administrative budget line of DG Enlargement.

4.3. **Financial execution (contracts and payments)**

4.3.1. *Contracting*

During the reporting period, €181 million was contracted under the operational part of the programme.

By the contracting deadline of December 2009, **€247.6 i.e. 99.38%** (out of a total of €249.15 million of the operational part of the Aid Programme) was contracted. The bulk of these funds was contracted in the last quarter of the year.

As regards the staff and mission component of the programme (i.e. €9.85 million), €2.8 million remained unused due to the decision to use administrative credits for staff expenditure rather than operational credits as initially foreseen.

⁴ Approved by the Commission Decision n° 2928 (2009) of 22 April 2009.

4.3.2. *Payments*

During the reporting period, the European Commission disbursed €42 million. This was considerably lower than had been foreseen in the initial planning for the 2009 budget leading to the need to transfer €42 million of payments credits to other budget lines. The underperformance in payments was primarily due to the later than planned signature of many contracts which led to activities being delayed from 2009 into 2010.

Of the €259 million, €75.8 million (30%) in total was disbursed by end-2009.

4.4. **Monitoring**

The Interim Review Mechanism (IRM) serves as a forum to discuss in detail with the beneficiaries the implementation of the programme. One meeting of the IRM took place during the reporting period (June 2009).

4.5. **Audit and controls**

An internal audit was carried out in 2008 by DG Enlargement Internal Audit Capability Unit. The main recommendations focussing on assuring sound financial management in the specific legal circumstances prevailing in the northern part of Cyprus were implemented (with the exception of one recommendation, to recruit additional officials due to the lack of sufficient posts).

4.6. **Evaluation.**

In June 2009 an ad hoc evaluation was carried out by a team of external experts. The evaluation report recommended the continuation of the assistance to the Turkish Cypriot community and drew conclusions to be taken into account in programming future assistance such as a continuation of SME grant schemes and reconciliation measures.

4.7. **Information, Publicity and Visibility**

During the reporting period, **33** press releases were published on programme-related issues. 85 public events were organized. The Programme Team and the Commission Representation co-operated to increase the programme's visibility. Information campaigns were carried out using mass media, mostly for grant schemes. Cooperation with the Commission Representation in Cyprus for the dissemination of press releases, media interviews and other actions also contributed to increase visibility.

The InfoPoint project supported the visibility of the aid programme among the Turkish Cypriot community.

The two main visibility events were the 1) opening of the *Bedestan* in Nicosia widely attended by both communities of Cyprus and 2) the ceremony to mark the further €2 million EU funding for the CMP with the attendance of the Leaders of the two communities in Cyprus.

4.8. Consultations with the Government of the Republic of Cyprus

Meetings were held with representatives of the Government of the Republic of Cyprus, in particular when senior Commission officials visited the island. Working level meetings were also held with representatives of line ministries, particularly in the fields of environment, energy and telecommunications, with a view to taking into account island-wide planning aspects.

As regards the verification of property ownership, the Commission relied in 2010 on the continued co-operation with the relevant services of the Government of the Republic of Cyprus.

5. CONCLUSIONS

During the reporting period, activities focused on:

- (1) contracting: more than 60% of the operational part of the programme was contracted in the reporting period.
- (2) implementation: monitoring the use of EU funds by contractors and grant recipients.

Some challenges mentioned in previous reports are still present. In the reporting period issues affecting the Aid Programme implementation included:

- (1) Cooperation between Turkish Cypriot and Greek Cypriot communities: this is the key to the programme's success.
- (2) Low absorption capacity by the beneficiary community: the Turkish Cypriot community is small and receiving such large resources for projects contracted in such a concentrated timescale is a major challenge. However, improved capacity was noted in the course of 2009.
- (3) Delivery issue: The time needed to prepare, contract and implement projects has to a certain extent affected the credibility of the delivery of financial support from the EU. This problem will be substantially addressed by the high level of implementation expected in 2010 following the high level of contracting in 2009.
- (4) Property issue: Rights of private owners were rigorously respected. This particularly affected implementation of the waste management sector where three construction contracts were signed with a suspensive clause to allow sufficient time to regularise all property issues.
- (5) Sustainability issue: in key sectors (telecom, energy), there is a need to convince the Turkish Cypriot community of the importance of reform. This delays implementation and puts at risk sustainability of the investment.