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

**Eighth Annual Report 2013 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**

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1. INTRODUCTION

Council Regulation (EC) No 389/2006¹ (the "Aid Regulation") is the basis for the assistance to the Turkish Cypriot community (TCc) and requires annual reporting to the Council and the European Parliament. This report covers the year 2013.

2. PROGRAMMING OF THE ASSISTANCE

Between 2006 and the end of 2013, EUR 337 million was programmed for operations under the Aid Regulation. The 2013 programming (EUR 31 million²) used input from stakeholder workshops and from external evaluations, particularly an overall programme evaluation that took place during the year.

Due to the temporary nature of the assistance (until reunification takes place) and the financing from the margins of the EU Budget, the fundamental changes necessary for the eventual *acquis* roll-out were difficult to plan for. This problem was acknowledged by the European Court of Auditors (ECA) in a 2012 recommendation³. The Multiannual Financial Framework (MFF) 2014-20 provides a multi-annual perspective to the programme with a provision for annual funding for the first time. This will allow better planning for preparation for future implementation of the *acquis*. This has become more important in view of the reopening of settlement talks in 2014, since the Aid Regulation calls for immediate application of the *acquis* following the settlement.

3. IMPLEMENTATION MECHANISMS

The programme is implemented in the areas of the Republic of Cyprus in which the Government does not exercise effective control and where the application of the *acquis* is temporarily suspended pursuant to Protocol 10 of the Treaty of Accession. Assistance is implemented primarily through centralised management by the European Commission. Some projects are jointly managed with the United Nations Development Programme (UNDP).

The Commission operates in a unique political, legal and diplomatic context. *Ad hoc* arrangements are needed to implement the programme while respecting the principles of sound financial management. In EU-funded aid programmes, in normal circumstances, agreements with a beneficiary government would establish the legal framework for development assistance. No such agreements can be made for the

¹ OJ L65, 7.3.2006, p.5.

² Commission Decision C(2013)7969.

³ Special Report n° 6/2012 http://www.eca.europa.eu/Lists/ECADocuments/SR12_06/SR12_06_EN.PDF

assistance to the TCc and the Commission has to rely on what it understands to be the rules and conditions applicable locally. This introduces a certain level of risk. Management and mitigation of this risk is part of the Commission's responsibility and measures adopted include intensive monitoring and support to beneficiaries, revised payment conditions and a careful approach to the use of bank guarantees.

To ensure successful and sustainable implementation in this environment, the TCc must fully engage in the move towards *acquis* alignment. Cooperation between the Turkish Cypriot and Greek Cypriot communities remains necessary for full effectiveness of the programme and for achieving the ultimate goal of reunification.

The Programme Team uses the EU Programme Support Office (EUPSO) in the northern part of Nicosia. The Representation of the Commission in Cyprus also hosts meetings and seminars and communicates with the Cypriot public on the programme as part of its standard role.

The assistance includes a significant amount of grant support, particularly to non-public actors. Management of the relatively small contracts under these schemes is demanding in terms of the Programme Team's resources and the Commission continues to investigate indirect management modes. A Delegation Agreement was signed in December for outsourcing the management of the scholarship programme to the British Council for two academic years in 2014-16.

4. IMPLEMENTATION DURING THE REPORTING PERIOD

4.1. General overview

The year 2013 saw some significant successes: the new Nicosia bicomunal wastewater treatment plant at Mia Milia/Haspolat, and the largest in Cyprus, was handed over; the work of the Committee on Missing Persons programme accelerated, achieving the highest rate so far of identification of missing persons; the work on cultural heritage achieved some high profile project completions; the highly valued scholarship programme reached more students in 2013 than in any previous year and grants supporting schools and farmers were signed. An overall programme evaluation indicated generally "good" quality. The Commission was also successful in achieving a multiannual perspective for the support to the TCc under the MFF for 2014-20.

As in 2012, many contracts were closed during the year (229), including a large number of grants from earlier schemes, leaving 208 contracts open at the end of 2013. New activities were dominated by grant campaigns supporting SMEs, civil society organisations, schools and rural and community development.

Due to the specific circumstances of the intervention, sector development programmes cannot easily be conceived. This, together with the lack of an *acquis*-aligned framework in many areas, means that problems of local organisational efficiency, resource management and planning are difficult to address, which has been a feature of the programme since the beginning and manifests itself particularly in challenges to sustainability. The Commission continues to follow up completed projects to ensure, for example, that correct maintenance and operation is being observed. The issue of sustainability has been highlighted by both the ECA in their 2012 Special Report and the 2013 programme evaluation.

Another general problem has been the variable annual funding from the margins of the EU Budget and the nature of the aid instrument, which is temporary, but undefined in length. This has hampered both planning and sustainability, but will be addressed in the MFF 2014-20.

One specific issue, which escalated in 2013, was the referral by local contractors of contract disputes to the local "courts" and resultant "court" awards against the Commission including an injunction preventing the call-up of bank guarantees issued by local banks. This was partly defused through changes to local legal texts, but it is yet to be seen if the protection of locally-issued bank guarantees is adequate. Additionally, this protection does not seem to have retroactive effect and the Commission is still unable to cash some bank guarantees. This problem has delayed grant contract signatures.

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 TCc, with particular emphasis on the economic integration of the island, on improving contacts between the two communities and with the EU, and on preparation for the *acquis*. There were activities in each of these areas in 2013.

4.2.1. Objective 1: Developing and restructuring of infrastructure

In the energy sector, all projects were successfully completed and related contracts totalling EUR 11.6 million were closed by the end of 2013. The 1.27 MW Solar Power Plant is running well and is integrated with the control system for remote monitoring. The Commission continues to monitor the operation by the beneficiary.

After delays, the testing phase of the "next generation network" telecommunications equipment was close to completion, with the system expected to go live during the first half of 2014. The conditions necessary to separate the provision of services from the network operation are still missing, however, and the full liberalisation of the sector is unlikely in 2014.

In the area of *traffic safety*, projects costing EUR 2.4 million have been completed under the Aid Programme. The last contracts were closed in 2013.

A new Nicosia bicommunal *wastewater treatment* plant at Mia Milia/Haspolat, co-funded by the EU and the Sewerage Board of Nicosia has been completed and was handed over in July. The construction work was implemented through the UNDP. The two municipalities have signed a contract for operation and maintenance of the plant. The treated water re-use, including return to the government controlled areas, remains to be addressed.

The defects notification period for the Morphou/Güzelyurt *wastewater treatment* plant, taken over in 2012, was extended into 2014, mainly to address some corrosion issues. The beneficiary already has an operation and maintenance contract in place.

The new *wastewater treatment* plant in Famagusta was handed over in October, but problems of high salinity in the influent causing corrosion remain to be solved. Operation and maintenance is funded by the municipality and is undertaken by the same operator as for the plant in Morphou/Güzelyurt.

The 45 km water supply network and the 47 km sewer network of Famagusta has been laid. Many defects remain, however, and only the water network and seven pumping stations have been taken over. This project has been much delayed and the contract was terminated in December. At the end of 2013, the dispute arbitration process specified in the contract was underway.

Following the completion of the water/wastewater capacity building programme in 2012, an evaluation was carried out and a workshop was held to design a follow-on programme.

The water/wastewater sector has, therefore, been a difficult one in which to work, with corrosion issues due to the high salinity of the ground water and poor contractor performance. The Commission has had to extend its involvement in order to ensure that sustainable maintenance and operation arrangements are in place for the wastewater treatment plants that have been delivered.

On *nature protection*, information and management centres in four Special Environmental Protection Areas (SEPAs) remain to be finished following termination of the construction contract in 2011. Preparations have been made for completion of the facilities through a contribution agreement with UNDP. Work remains to protect the natural environment and to fully implement the management plans for the SEPAs. The Commission continues to express its concerns to the TCc, for example about extensive quarrying in the Kyrenia Mountains.

In the area of *solid waste*, final performance certificates were issued in April for the new Koutsoventis/Güngör landfill and in September for the rehabilitated Kato Dhikomo/Aşağı Dikmen dump. A workshop was held in June to discuss further involvement following completion of the infrastructure and of the solid waste management capacity building project. Input was taken from the 2012 sector needs assessment,

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

Technical support was given to farmers, and *rural development* stakeholders in the fields of veterinary health, animal husbandry and disease eradication, plant health, crop diversification, organic farming and support for grant implementation. Tenders were launched for services on animal diseases eradication and on the design of a system for disposal of animal by-products.

Under the third *rural development* grant call, 39 contracts for a value of around EUR 3 million were signed in 2013 for increasing competitiveness, diversification and sustainability.

A third call for proposals (EUR 3 million) for *community development* grant projects in rural areas was launched in May with contracts to be signed in 2014. The objectives of the call are to enhance natural and intangible cultural heritage assets, to improve basic community services and to reinforce social cohesion and local governance in rural areas.

Out of the 37 grants awarded under earlier community development schemes, four were closed during 2013 and 13 remained ongoing. Some of these earlier grants are still suffering delays, arising primarily from delays of grant beneficiaries in finalising infrastructure works.

Within the project *Upgrading of Urban and Local Infrastructure* implemented through joint management with UNDP, following a second grant call in 2012, 17 small grants were awarded and implemented in 2013 in villages where EU-financed renovations have been carried out, or on activities in the markets of Famagusta and Nicosia. A third call for proposals was launched in June 2013, targeting protection of the environment and cultural heritage in Karpasia/Karpaz, and 11 grants were awarded.

In the *education* sector, ten grants for schools were signed following a EUR 700,000 call launched in 2012. Projects supported include modernising science labs, the introduction of new teaching methods in a pre-primary school, as well as projects supporting the arts and environmental education and bicommunal activities. An evaluation of the EU support to the education sector and a needs assessment was carried out in the first half of 2013.

After completion of the *vocational education training and labour market (VETLAM)* project in 2012 and the evaluation, tendering started for a continuation project (VETLAM II) covering development and promotion of vocational education and training (VET) systems, life-long learning and active labour market measures.

Following the EUR 5 million grant call in 2012 *Supporting SME Competitiveness*, training was delivered to potential beneficiaries and applications from 282 enterprises were processed. Grant award is delayed until confirmation on the security of locally issued bank guarantees is received. The very active technical assistance (TA) to the economic sector was extended for three months until September 2013 and, during the year, support was given on the SME strategy, the e-strategy and training was delivered to business support organisations, SMEs, NGOs, academic centres and municipalities on entrepreneurship, export, research and development, local handicrafts, history and culture of Cyprus, nature conservation, IT and other topics. The TA gave special attention to the Karpasia/Karpaz region with bi-communal village activities. A number of business support publications were also produced. There was a closing event in September.

A "market mapping" on processed food was started at the end of the year.

A meeting of the Roundtable on Trade and Commerce, the forum for donors and beneficiaries was held in July.

The World Bank monitors economic progress and produces specialist reports through a Trust Fund which was extended until the end of 2014.

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

Support to the *Committee on Missing Persons (CMP)*, managed jointly with UNDP, continued. The year 2013 was the most successful so far with 140 individuals identified and returned to their families, bringing the total of identified persons since 2006 to 477. Access was granted during the course of 2013 to an area previously inaccessible due to the Turkish military presence. In December, the sixth contribution agreement was signed with the UNDP, providing further EUR 2.6 million of EU funding support to the CMP. The EU is the major donor to the CMP and total EU support is now EUR 12.1 million. In order to further improve the trust

between the two communities, funds have been provided under the new contribution agreement for enhanced awareness and information activities.

All the remaining projects funded under the past three grant schemes of the Cypriot Civil Society in Action programme were completed in 2013. An external evaluation of the programme since 2007 was performed and lessons were incorporated into a new EUR 2.5 million grant scheme that was launched in September to strengthen the role of civil society organisations in democratic engagement in the TCc and within the European Union. Grant awards will be made in 2014 and the new grant scheme will be supported by a technical assistance contract to build capacity within the organisations.

Work on protection of *Cultural Heritage* under the framework of the bicomunal Technical Committee on Cultural Heritage (TCCH) advanced in 2013 with the completion of projects for Melandrina Church, Profitis Elias Church, Panagia Church and Denya Mosque. The TC contractors' boycott programme was resolved early in the year. Field visits and closing events have been organized and increased the programme visibility, highlighting the importance of restoration of cultural heritage as a vehicle for reconciliation between the two communities. A second contribution agreement was signed with UNDP for an additional EUR 2 million. This was marked by an event held in November with the participation of the representatives of the Cypriot leaders and members of the TCCH.

4.2.4. *Objective 4: Bringing the TCc closer to the EU*

The widely appreciated scholarship programme was extended in scope, following the 2012 assessment and 181 grants were awarded to undergraduate and postgraduate students, teachers, researchers and professionals for the academic year 2013/14. The scheme also offered scholarships for short professional courses and for internships. As a result, the 2013 scheme was the largest since the student programme started in 2007. Outsourcing of the scholarship scheme was investigated and a Delegation Agreement was signed with the British Council for the two years 2014-16, after which it will be reviewed.

The first *Infopoint* project finished in 2013. A tender has been launched for a new *Infopoint* in 2014. The aim of this project is to inform the public about EU policies and the Aid Programme. Activities will include a significant number of seminars, conferences, workshops and visibility events for the benefit of the Turkish Cypriot community.

4.2.5. *Objectives 5/6: Preparing the Turkish Cypriot community to introduce and implement the acquis*

The Commission's Technical Assistance and Information Exchange (TAIEX) instrument helps prepare the TCc for implementation of the *acquis* following the settlement of the Cyprus problem. In 2013, assistance focused on 13 main areas of the *acquis*: Free Movement of Capital, Public Procurement, Company Law, Competition Policy, Financial Services, Agriculture and Rural Development, Food Safety, Veterinary and Phytosanitary Policy, Road Transport, Statistics, Social Policy and Employment, Environment, Consumer and Health Protection, Financial Control. Work was also conducted on three newer areas: Free Movement of Goods, Intellectual Property Rights and Mutual Recognition of Professional Qualifications.

EU Member State experts carried out 456 actions in 2013, including training courses, workshops, study visits and legal expert counselling. Preparation of the TCc for future roll-out of the *acquis* remained limited. There were no TAIEX actions after February in the field of statistics. The TCc took action, however, on animal welfare, environment and insurance. The Commission organised TAIEX stakeholders' meetings in Brussels in January and September 2013 in order to steer the overall TAIEX implementation.

Support to trade across the Green Line (Regulation 866/2004) continued. EU Member State experts carried out regular phytosanitary inspections of potatoes and citrus products. Analyses of local honey showed that the conditions of Commission Decision 2007/330, related to the movement of animal products, continue to be met. Independent experts produced an updated list of vessels whose catch can be traded across the Green Line, as they comply with the requirements of the same decision.

4.3. Financial execution (contracts and payments)

4.3.1. Contracting

Commitments in 2013 totalled EUR19.7 million, remaining below the ambitious forecast made for the year. Grant signature under the EUR 5 million SME scheme from the 2011 allocation will only be possible when the status of local bank guarantees is satisfactorily resolved.

4.3.2. Payments

Compared with the forecast for the year, payment performance was better in 2013 than in the previous two years (EUR18.5 million, 76% of the forecast). Payments were especially impacted by continuing problems hampering handover and final payment for the telecom equipment and by delays in grant prefinancing (rural development and SME schemes).

4.4. Monitoring

The Commission has direct responsibility for implementation of most projects (centralised management). The level of supervision by Commission staff is high, with "spot-check" visits, site meetings, steering committees. A dedicated Programme Management Unit monitors grant implementation for villages, SMEs and rural enterprises and supports grant beneficiaries. TAIEX activities are monitored through more than 20 Project Steering Groups, plus biannual Monitoring Mechanism meetings. TAIEX logistics are monitored through the on-line TAIEX Management System.

A more systematic process for planning of monitoring and recording of output is being developed.

4.5. Audit and controls

The Commission conducted an audit in 2013 on Joint Management to assess internal control systems of the Directorate-General for Enlargement. This required that recording of field monitoring should be improved (see 4.4).

A financial monitoring and audit programme on early grant campaigns was finished in 2012. A new audit programme is planned for 2014, when recently launched grant schemes become sufficiently mature.

The Commission continued to respond to recommendations of the ECA 2012 audit. The MFF 2014-20 provides the recommended multi-annual perspective for funding. The new Staff Regulation will allow longer duration of staff contracts from 2014 onwards.

4.6. Evaluation

A major external programme evaluation was carried out in 2013. Overall, programming was found to be "generally good", but recommendations covering indicator selection, risk management, monitoring and TC involvement in planning were made. Sector assessments were also carried out: 1) progress in solid waste management was reviewed and a priority list of interventions was established; 2) an evaluation of assistance in the education sector indicated low impact of the attempts at sector reform due to low buy-in by local stakeholders, but school grant schemes were well received; 3) an evaluation of EU financed support to civil society identified the need for more capacity building. 4) evaluations of TAIEX and of the water/waste capacity building programme were launched and the reports will be finalised in 2014.

4.7. Information, Publicity and Visibility

There were 49 visibility actions in 2013 including project events, exhibitions and ceremonies, information sessions on grants, training sessions on projects, plus inauguration of village-based projects. Particularly noteworthy events were the ceremonies for the completion of the Panagia church conservation project in Trachoni/Demirhan in December and for the launch of the next phase of the cultural heritage protection programme in November; events for community scholarship grantees and for grantees of the rural development scheme. Briefings and project visits for EU Member States representatives were organised in April and December. Press releases on the aid programme for the TCc were disseminated by the Commission Representation in Cyprus.

4.8. Consultations with the Government of the Republic of Cyprus

Regular meetings were held with representatives of the Government of the Republic of Cyprus, in particular when senior Commission officials visited the island. The Commission continues to rely on its cooperation for verification of property rights, and also meets regularly with the Permanent Representation in Brussels.

5. CONCLUSIONS

Progress towards meeting the main objective of the Regulation to *facilitate the reunification of Cyprus by encouraging the economic development* is difficult to achieve, given the operating context in the northern part of the island. The settlement will be attained through a political process, but the EU assistance programme will be vital in accelerating the economic and social integration.

Despite operating in the challenging environment of the northern part of Cyprus, solid achievements are now visible, building on previously completed projects not described in this report for 2013. The value of a consistent approach is also being demonstrated, since some projects are now becoming much more efficient and productive after several years of implementation. The more stable perspective offered by the MFF 2014-20 should further support this trend. Both the ECA audit in

2012 and the 2013 programme evaluation were generally positive in their conclusions, although lessons are continuously being learned.

In some areas, fully successful intervention remains difficult and long-term sustainability does remain an issue, because of low capacity of the beneficiaries and lack of local resources, constraining TCc engagement and affecting project sustainability. The Commission cannot withdraw, however, from work in such areas since many are central planks of the *acquis* and vital to the economic and social well-being of EU citizens.

The year 2013 was a year in which previously identified risks, particularly those related to the protection of contracts and bank guarantees, actually led to serious problems and delays in some projects. This negatively affected absorption capacity. It is the Commission's task not only to monitor and control the risk level, but also to ensure that allocated funds are fully absorbed to deal with the social and economic challenges that undoubtedly exist.

Delivery of infrastructure and major equipment continues to be difficult, but where these projects have succeeded, they have been visible and important successes. Even less visible projects previously delivered, such as renewed water networks, have led to significant improvements in daily life.