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

**Second Annual Report 2007 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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COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT AND THE COUNCIL

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1. INTRODUCTION

On 26 April 2004, the Council stated the following:

“The Turkish Cypriot community has expressed their clear desire for a future within the European Union. The Council is determined to put an end to the isolation of the Turkish Cypriot community and to facilitate the reunification of Cyprus by encouraging the economic development of the Turkish Cypriot community. The Council invited the Commission to bring forward comprehensive proposals to this end, with particular emphasis on the economic integration of the island and on improving contact between the two communities and with the EU. The Council recommended that the 259 million euro already earmarked for the northern part of Cyprus in the event of a settlement now be used for this purpose.”

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.

This second report covers the period from 1 March until 31 December 2007.

2. PROGRAMMING OF THE ASSISTANCE

No additional resources requiring programming were made available under the 2007 budget. No reprogramming was required during the reporting period. Minor changes were made to some project fiches which did not require modifications to the five Commission Decisions adopted in 2006.

3. IMPLEMENTATION MECHANISMS

The European Commission is responsible for administering the assistance. The implementation mechanisms were dictated by the *ad hoc* nature of this aid programme and of its beneficiaries. The programme is implemented in an EU Member State but 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 Team of Commission officials and contract agents was set up in 2006 to implement the programme as part of the Task Force Turkish Cypriot community within

¹ OJ L65, 7.3.2006, p.5.

DG Enlargement. During the reporting period, the Programme Team was further strengthened. By December 2007 it comprised 27 staff including 3 Commission officials, 14 contract agents and 10 local staff provided by a private contractor (GTZ) for administrative and logistical support.

The Programme Team, working in Cyprus on a long-term mission basis, continued to use the facilities of the Programme Support Office established in September 2006, located in the northern part of the walled city of Nicosia. Office logistics continued to be provided by a private contractor (GTZ) under a contract valid until 20 June 2008. The Programme Support Office has proven a very important tool in ensuring co-ordination with Turkish Cypriot stakeholders and providing a venue for meetings and seminars. Initially selected premises proved too small due to the growing number of staff needed to contract the funds by the end of 2009. A decision was taken in autumn 2007 to move to new premises after necessary refurbishment². The tender for office management services (premises, equipment, support staff) after June 2008 was also launched.

4. IMPLEMENTATION DURING THE REPORTING PERIOD

4.1. General overview

The Commission is implementing this aid programme in a unique political, legal and diplomatic context. During the reporting period, the Commission was confronted with some practical consequences of operating in such an environment. *Ad hoc* arrangements had to be put in place enabling the Commission to proceed with implementation whilst respecting principles of sound financial management.

It should be recalled that in the case of similar EC funded aid programmes, financing agreements with the government of the beneficiary country normally set the rules and conditions under which the assistance shall be implemented. They regulate issues such as taxation, work and residence permits. For this aid programme for the economic development of the Turkish Cypriot community no such agreement exists. Therefore, the Commission has to rely, for the implementation of this programme, on what it understands to be currently the rules and conditions locally applicable. These are not enforceable and might change during the lifetime of a contract. The Commission entering into contractual arrangement with its contractors faces thus the risk of having to take on liabilities normally not encountered in contexts where there is a financing agreement. Contractors might cost their services at a higher price to protect themselves from these uncertainties.

The Commission heavily relies on the support of the Turkish Cypriot community to make this programme a success, firstly in its implementation phase and then, when the sustainability of completed projects must be ensured. The Commission strives to instil ownership of EC financed projects in local beneficiaries. Turkish Cypriot experts are involved in drawing up technical specifications and Terms of Reference. Turkish Cypriot stakeholders have been actively involved in the tendering phase, with their experts included in tender evaluation panels. After contracts are awarded, Turkish Cypriot beneficiaries play an active part in Steering Committees.

² The move to new premises took place in June 2008.

The Turkish Cypriot community identified counterparts for each project. An Aid Committee was set up. Turkish Cypriots are not accustomed to EC procedures. The learning curve is steep and, whilst considerable progress has been made, results are mixed as regards absorption capacity. More needs to be done to ensure long-term sustainability. The short timeframe the Commission has to contract the aid programme is an additional complication.

Some of the risks highlighted in the first annual report, in particular how the overall political context impacts on implementation of the aid, were encountered during this reporting period.

Problems arose in the reconciliation projects. De-mining started late, due to the Turkish Cypriot leadership's initial unwillingness to use the aid programme for these activities. The History Teaching project (based on the co-operation developed between teachers and trade unions of both communities during the 2004-2006 period) could not start due to reservations of the Government of the Republic of Cyprus as regards the Commission's involvement in a project to be implemented by the Council of Europe.

As regards property, the considerable time required by the Government of the Republic of Cyprus to provide information on private Greek Cypriot owners' names added delays to an already tight timescale. Making up the delay will depend, *inter alia*, on such information being released more rapidly.

Works, services and supplies are procured according to EC external aid rules. During the reporting period, the first launched works tenders were negatively affected by the decision of local Turkish Cypriot contractors not to take part in EC funded tenders because the open, competitive approach to tendering under EC procurement rules undermined local interests.

4.2. Progress by objective

Financial assistance under the aid programme focuses on five priority objectives (see Annex 1 for breakdown by objective and by project). Out of the overall allocation of €259 million, €240.15 million was allocated to the operational part of the aid programme. Key activities and issues during the reporting period were as follows:

4.2.1. Objective 1: Developing and restructuring of infrastructure

During the reporting period, activities focused on launching the service tenders for preparing the conceptual design and tender documents for the large works and supply components to be funded under this priority.

The launch of the first works tender for the much-needed replacement of asbestos pipes in the northern part of Nicosia ran into difficulties which were exacerbated by the decision by local Turkish Cypriot companies not to participate (see point 4.1 above). Few offers were received (the tender's relatively low value meant it did not attract much interest from international construction companies), no offer was deemed compliant and the tender procedure had to be cancelled³.

³ The decision to cancel the tender was taken in February 2008.

On nature protection, the Commission sought to fast-track the preparation of a management plan for the Karpaz peninsula. During summer 2007, the construction of an electricity line from the village of Dipkarpaz/Rizokarpazo to the tip of the Karpaz peninsula led to concerns that haphazard development would undermine the area's ecological value, hence the need to help the Turkish Cypriot community to rapidly prepare the management plan for the Karpaz specially protected area. The lack of suitable offers from framework contractors, led to the decision to include this activity in the main service tender launched for this purpose⁴.

A contract was signed for the “Feasibility study for the rehabilitation of the Lefke mining area”. Before the contract was signed, the Commission was informed that a private sector company had been awarded a concession to clean up of the area, in exchange for the rights to set up a free port area nearby. The Commission signed the contract only when it became clear that the chosen consultant was able to operate effectively and deliver on its contractual obligations.

A draft solid waste management plan was completed in the autumn and discussed with the Turkish Cypriot community. This plan is an important prerequisite for launching works and supply contracts under the Solid Waste Management Sector Programme. Options were identified for the location of a new landfill and a waste transfer station.

In the energy sector, preparation of the first tender for the provision of energy meters fell behind schedule due to delays in receiving comments on the technical specifications from Turkish Cypriot stakeholders. EC support for a SCADA⁵ system was delayed while stakeholders considered financing the project from different sources.

In telecommunications, the planned concept review study was carried out to prepare the technical assistance to restructure the sector in terms of regulation and network operations, and the investments required for enhancing the existing operational infrastructure so that it fully complies with IP⁶-based networking and can also reach customers in remote areas.

The Traffic Safety programme was launched, with the contracting of the project management component.

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

In the field of rural development, an Interim Rural Development Plan was prepared, resulting in the launch of a pilot call for farmers, focused on improving hygiene on sheep and goat farms.

As for human resources development, a small pilot project for supplying to supply IT equipment to three primary schools ran into difficulties and had to be cancelled due to local suppliers not bidding. A two-day workshop was organised on leadership training for head teachers. Arrangements were also concluded with the European Training

⁴ The Commission signed the service contract "Technical assistance for management and protection of potential Natura 2000 sites in the northern part of Cyprus" in April 2008.

⁵ Supervisory Control and Data Acquisition

⁶ Internet Provider

Foundation so that it can provide support to the Commission in implementing the human resources development sector programme.

Upgrading of urban and local infrastructure is undertaken in joint management with UNDP. Work started on the last phase of the restoration of the *Bedestan* building in the walled city of Nicosia. Villages were identified for pilot projects such as restoration of village squares. However, a project to restore the water supply in a small village had to be cancelled as no local contractors bid.

Implementation of the "Micro and small enterprise loan programme" ran into difficulty as the implementation mechanism laid down in the Commission Decision (implementation via a grant agreement with a development bank and a service contract) did not prove feasible and will need to be reviewed. This resulted from the incompatibility between the profit-oriented nature of development banks and the requirement deriving from the EC Financial Regulation that grants should not generate profits.

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

A grant agreement was signed to support the Committee on Missing Persons (CMP). The EC contribution is the largest single financial contribution to the CMP. In 2007, the CMP reached the important stage of starting to return remains of missing persons to their families. A website in three languages (English, Greek and Turkish) was also developed with EC support. The first call for proposals to support civil society was launched.

Successful implementation in this area is heavily dependent on the political context. In this respect, the following problems were encountered:

- (1) *Demining*: the grant agreement was signed with UNDP in March 2007 but implementation was effectively blocked until July due the Turkish Cypriot leadership's reservations. Their initial position was that demining should be funded through different budgetary means as in the 2004-2006 period⁷ and not under the €259 million aid programme. Additionally, an agreement was reached only in December 2007 between UNFICYP and the Turkish Army on releasing the information (e.g. mining maps) required for demining activities to be implemented at full speed. UNDP had deployed a demining team *in situ* since April soon after contract signature. These delays caused additional costs not foreseen at the beginning.
- (2) *History teaching project*: the Commission signed the contract in July 2007 but the Council of Europe did not countersign as it did not deem itself to be in a position to implement the project. The Republic of Cyprus put forward objections, saying that the way the project was structured and funded altered its previous existing co-operation framework with the Council of Europe and had requested the

⁷ € million was deployed for demining in Cyprus through a pilot project/preparatory action during the 2004-2006 period.

conclusion of formal arrangements (through the signing of a memorandum of understanding)⁸ not acceptable to the Council of Europe.

- (3) *Academy of Political Studies*: although the contract was signed during the reporting period, the Council of Europe decided to delay implementation until after the Republic of Cyprus Presidential elections in February 2008.

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

The main achievement to report is the finalisation of the first call for proposals for scholarships for the 2007/2008 academic year 105 scholarship were available (25 for teachers, 80 for undergraduates), but only 39 applications were received leading to the award of only 30 grants (for 15 teachers and 15 undergraduate students). The low take up, particularly by undergraduates, was imputed to the scheme's novelty and lack of sufficient time to advertise it properly. Moreover, local universities would lose fee income from undergraduate students leaving for a year abroad, hence their reluctance to promote the scheme to their students. The programme has been extended to postgraduate students for the 2008/2009 academic year, for which the call was launched in September.

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

This priority objective is mainly implemented through the Commission's Technical Assistance Information Exchange Instrument (TAIEX).

By the end of 2007, 122 events were organised involving 197 experts. Assistance focused mainly on the five areas below. Much of this was also complementary to related investment projects and grant schemes funded from other parts of the aid programme.

- Support for the implementation of the Green Line Regulation, in particular through mobilising phytosanitary experts to oversee planting, growing, harvesting and trade in potatoes.
- Agriculture, in particular the analysis of existing policies and the reforms required for the future introduction of the *acquis*. Identifying priorities for the Interim Rural Development Programme was a key activity.
- Environment, in particular identifying priority areas for future training and capacity building relating to the *acquis*. Work on designating the boundaries of the nature protection areas with future potential Natura 2000 status is a case in point where management plans under Objective 2 are foreseen.
- Food safety, where activities included support for the Turkish Cypriot community's response to the foot-and-mouth disease outbreak on the island in October 2007; assessing future investment needs to meet veterinary standards in both animal health and veterinary public health; and priorities for future training and capacity building concerning the *acquis*.

⁸ At the time of adoption of this report, the project continues to be blocked. Over a year has elapsed and the contract will have to be modified to take account of the changed situation.

- Statistics, including a needs analysis for developing a more reliable and comparable data set for the northern part of Cyprus which would support the creation of island-wide statistics, in line with EU standards, following reunification.

Under this priority objective, a project was also launched to review the current state of play on how existing environment services are delivered and to suggest improvements.

4.2.6. *Unallocated Technical Assistance and Programme Reserve Facility*

No use was made of this facility during the reporting period.

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

A total of €18.85 million (i.e. 7.2% of the overall financial allocation) was earmarked to help the Commission implement the aid programme. Assistance covers costs of staff involved in the implementation of the programme (contract agents and detached national experts) and their mission costs, as well as costs linked to the Programme Support Office. Contracts were signed to assist the Commission in the contracting process, e.g. writing Terms of Reference, assessing proposals, etc.

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

Annexes 2 and 3 list respectively contracts signed during the reporting period and in total.

4.3.1. *Contracting*

During the reporting period, a total of €17.5 million was contracted. Of this, around €17 million was contracted under the operational part of the aid programme and around €0.5 million for supporting activities under Article 4(3) of the aid Regulation.

By the end of 2007, nearly €33 million was contracted in total. Of this amount, around €1.2 million was contracted under the operational part and around €1.8 million for supporting activities. Annex 4 shows the breakdown of contracts under the operational part and supporting activities.

4.3.2. *Payments*

During the reporting period, the Commission disbursed to its contractors a sum of around €8.1 million and spent around €0.9 million on staff and mission costs⁹.

By the end of 2007, the Commission had disbursed to its contractors a total a sum of around €12.29 million and had spent around €1.24 million on staff and mission costs.

4.4. **Monitoring**

During the reporting period, the Commission set up an Implementation Review Mechanism (IRM) involving Turkish Cypriot beneficiaries. The IRM's aim is to

⁹ Expenditure for staff and missions are accounted separately from other support expenditure, due to the specific nature of these activities

periodically review progress towards achieving programme objectives and to support effectiveness and quality in the implementation of the aid programme for the Turkish Cypriot community. It also aims to maximise ownership of the programme by Turkish Cypriot beneficiaries, a crucial prerequisite for ensuring success in implementation and sustainability.

The first meeting of the IRM took place on 20 September 2007. Afterwards, a series of action points were established to speed up and improve programme implementation, their achievement being closely monitored via regular meetings between the Programme Team and Turkish Cypriot beneficiaries and stakeholders.

4.5. Information, Publicity and Visibility

Visibility is important to show to the Turkish Cypriot community at large that the EU is supporting them. During the reporting period, 15 press releases¹⁰ were issued, in particular to highlight the launch of calls for proposals and projects. Two interviews were given to Turkish Cypriot media. Three main visibility events were organised: 1) a "Bon Voyage" reception (attended by the Turkish Cypriot leader Mehmet Ali Talat); for the students and teachers awarded a community scholarship for the 2007/2008 academic year 2) a ceremony marking six years of successful co-operation between UNDP and the Commission, on the occasion of the signature of the last grant agreement planned under by the programme; and 3) the launch of the EC-funded website of the Committee on Missing Persons. Leaflets were produced to publicise certain projects and a website developed to promote the community scholarship scheme.

Additionally, the DG Enlargement website:

http://ec.europa.eu/enlargement/turkish_cypriot_community/index_en.htm continues to be used to publicise the aid programme and includes the text of the aid Regulation the Commission Financing Decisions and related documents.

4.6. Consultations with the Government of the Republic of Cyprus

In a statement inserted in the Council Minutes when the aid Regulation was adopted, the Commission, taking into account the existing political situation in Cyprus and the aim of integrating and reunifying the island, *"declared its readiness to consult the Government of the Republic of Cyprus about the major aspects of the implementation of assistance under this Regulation. The Commission also declared its readiness to consult the Government of the Republic of Cyprus if feasibility studies leave doubt as to whether actions to be financed under this regulation might affect property rights."*

After the programming phase, meetings were held with representatives of the Government of the Republic of Cyprus, in particular when senior Commission officials visited the island. There were seven such visits during the reporting period. 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, where appropriate in line with Recital 8 of the aid Regulation.

¹⁰ 17 press releases were issued in total since the start of implementation.

As for property rights, during the reporting period, a few small infrastructure projects were initiated, mainly for upgrading urban and local infrastructure where implementation is in joint management with UNDP. To this end, the Commission requested the support of the Republic of Cyprus to confirm the names of private owners. The time required by the Republic of Cyprus to answer such requests is proving long. This risks becoming a major stumbling block putting investment projects at risk. Obtaining the private owners' names is only the first step. The Commission must then request and receive their consent before signing works contracts.

5. CONCLUSIONS

During the reporting period, activities focused on:

- (1) Reaching cruising speed in implementation: preparatory measures in terms of preparing tender documents, as well as calls for proposal for grant schemes and works and service contracts were launched. All direct agreements non entailing calls for proposals as mentioned in the Commission Decisions were signed with UNDP and the Council of Europe with the exception of the History Teaching project where the Council of Europe did not countersign.
- (2) Consolidating the implementation mechanisms by recruiting additional staff and putting in place the required implementation procedures. Due to programme's specific nature and the context in which the Commission is operating, this has entailed tailor-made arrangements.

Implementation is and remains difficult because of the unique context within which the Commission is operating. Some of the challenges identified in the first annual report were encountered also during the course of 2007 and remain valid for the remainder of the implementation period:

- (1) Tight contracting deadlines and squeezing of the programme duration:
 - (a) Contracting of large-scale infrastructure investments within three years is proving challenging due to the lack of previous project preparation.
 - (b) Activities planned to be carried out on an annual basis can only take place for three consecutive years (2007-2009) rather than the originally planned five (2005-2009). 2009 will be the last year when call for proposals for grant schemes for farmers, schools, local communities, civil society organisations, etc. will be launched. The last call for the scholarship scheme will be in September 2008. Additional funding will be needed to continue to support the Turkish Cypriot community after 2009.
- (2) Property issue: the location of most planned infrastructure investments has yet to be determined. Given the amount of property owned by Greek Cypriot private owners¹¹, some investments would be able to proceed only if these owners give their consent. The considerable time required by the Government of the Republic

¹¹ It is estimated that 78% of privately owned land in the northern part of Cyprus belongs to Greek Cypriot private owners.

of Cyprus to provide information on private owners' names and the need to obtain consent has to be factored into an already very tight implementation schedule. Reserve projects will be prepared, in order to mitigate the risks of some projects not being able to go ahead due to the owners' lack of consent, but this might not be a sufficient mitigating measure to ensure contracting of all the planned investment projects.

- (3) Low absorption capacity by the beneficiary community: the Turkish Cypriot community is small and not well-equipped in terms of structures to receive such large resources in such a short time. Despite increasing ownership and co-operation, results are still mixed on this front.
- (4) Co-operation between the Turkish Cypriot and Greek Cypriot communities: the programme's success of the programme in attaining the overall objective of facilitating the reunification of Cyprus depends greatly on successful co-operation between the two communities on the island. Political issues not directly related to the aid programme *per se* but, rather, to the overall political context might induce either community to block implementation of certain parts of the programme. Implementation would be greatly facilitated by progress on the reunification process. The decision taken by the two Leaders to start their full-fledged negotiations on 3 September 2008, under the good offices mission of the United Nations Secretary-General will create a positive framework for facilitating the implementation and the success of this aid programme.