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COMMISSION OF THE EUROPEAN COMMUNITIES

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

**Third Annual Report 2008 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 third report covers the period from 1 January until 31 December 2008.

2008 saw the start of UN-facilitated talks on a comprehensive settlement between two leaders of Cypriot communities. By the end of the year, 13 rounds of negotiation had been held.

2. PROGRAMMING OF THE ASSISTANCE

No additional resources requiring programming were made available under the 2008 budget.

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 DG Enlargement. During the reporting period, the Programme Team was further strengthened. By December 2008 it comprised 38 staff including 3 Commission officials, 23 contract agents and 12 local staff provided by a private contractor (Deutsche Gesellschaft für Technische Zusammenarbeit - GTZ) for administrative and logistical support.

The Programme Team, working on long-term mission in Cyprus, continued to use the Programme Support Office established in September 2006, located in the northern part of Nicosia. The Programme Support Office provides a venue for meetings and seminars with Turkish Cypriot stakeholders. It also allows direct supervision of contractors. Due to growing staff numbers, the office moved to larger premises in June 2008. Office logistics continue to be provided by a private contractor (GTZ) under a contract that runs until June 2012. The Representation of the Commission in Cyprus also provides a venue for meetings and seminars.

¹ OJ L65, 7.3.2006, p.5.

2008 was the first year when the impact of the maximum three year rule for contract agents in the Programme Team was felt with three members of staff leaving the team and having to be replaced.

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

Generally in EC 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. These are not legally enforceable 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 potential liabilities that it would not normally encounter. Contractors might cost their services at a higher price to protect themselves from these uncertainties.

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 (e.g. intensive monitoring and support, revised payment conditions).

The Commission relies on the support of the Turkish Cypriot community to make this programme a sustainable success. Turkish Cypriot experts are involved in drawing up technical specifications and Terms of Reference. Turkish Cypriot experts are included in tender evaluation panels. After contracts are awarded, Turkish Cypriot beneficiaries play a key role in Steering Committees. More remains to be done to ensure long-term sustainability.

Turkish Cypriot counterparts are identified for each project. Turkish Cypriots are becoming familiar with EC procedures, in particular competitive tendering and selection procedures. As regards grant schemes, absorption capacity increased in the course of 2008.

Some of the risks highlighted in the Second Annual Report 2007, in particular how the overall political context impacts on implementation of the aid, were encountered during this reporting period.

In the course of February and March 2008 the Government of the Republic of Cyprus submitted eight cases against the Commission before the Court of First Instance as well as eight requests for interim measures, arguing that the text of the procurement notices used in the programme implementation could imply recognition

of a public authority other than the government of the Republic of Cyprus and requested the annulment of all procedures based on these notices.

The President of the Court of First Instance rejected the requests for interim measures, through Orders issued on 8 and 11 April 2008. The Commission decided, in order to avoid any further contestation, to modify the standard text of the procurement notices. In May 2008 the Government of the Republic of Cyprus withdrew the applications for the main cases. These court cases caused two to three months delays in contracting the eight projects.

There were further delays in completing the internal procedures and necessary negotiations for the signature of a €9 million agreement with KfW to provide SME financing by indirect centralised management.

As regards property, the Commission welcomes the increased pace of information provision by the Government of the Republic of Cyprus during the second part of 2008.

4.2. Progress by objective

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 for the *acquis communautaire*.

Financial assistance under the Programme focuses on five priority objectives. Out of the overall allocation of €259 million, €240.15 million was allocated to the operational part of the 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 preparation of the conceptual design and tender documents for the large works and supply components to be funded under this priority. In the case of the **water/wastewater** sector, the design consultant underperformed. Considerable efforts were required from the Programme Team to put contract implementation back on track.

In the field of water/wastewater, three works tenders were launched by December 2008 (including the re-launch of the tender for the replacement of asbestos pipes in the northern part of Nicosia²). Following the design phase, the estimated budget for the realisation of the water/wastewater projects increased by over €20 million, mainly due to the changed approach for the desalination plant at Kümkoý/Sirianokhori. It was initially intended to abstract and desalinate the brackish water from the Morphou aquifer. The approach was changed to seawater desalination in order to prevent further deterioration of the aquifer. The change implies a

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This first works contract was signed in February 2009

considerable increase in costs, which may have an impact on the funding for other planned projects.

On **nature protection**, a draft training strategy and awareness raising programme were developed as well as initial proposals for the management of the six potential Natura 2000 areas. Two public meetings were held for awareness raising - one for the general public and the other in one of the six³ potential Natura 2000 areas. Turkish Cypriots took further actions for the protection of these areas bringing to four the areas covered by special protection measures.

The preparation of studies and conceptual designs for the rehabilitation of the former **mining and ore processing** sites in the Lefke/Lefka region continued. Activities are aimed at identifying remediation solutions for the former mining areas, minimizing the impact on the environment and human health. Extensive site investigations were performed in 2008.

In the **solid waste** sector, the Commission signed a contract to prepare surveys, detailed designs and tender documents for the construction and rehabilitation of several waste management facilities based on the approved solid waste management plan. The main works were focused on detailed investigations and identification of locations and selection of technologies for the envisaged facilities. Also in the solid waste sector, the 2006 cost estimates proved to be on the low side. It will not be possible to rehabilitate all existing dumping sites through this programme.

In the **energy** sector, three activities were tendered out: for electricity meters, the meter calibration and testing system, and the reactive energy measurement programme. The initial tender was unsuccessful. A second tender led to a successful outcome at the end of the year. The savings realized by the competitive process will allow procurement of additional meters in 2009. A technical assistance team has been contracted to assist the Commission in monitoring project implementation, to provide support to the Turkish Cypriot electricity utility company to manage the sector, and to introduce multiple tariff systems. A tender was prepared to procure a SCADA system that allows real-time monitoring and control of the electricity network, with specifications that ensure compatibility with the SCADA system currently in place in the government-controlled areas. In the field of renewable energy, a tender was prepared for a pilot solar power plant to provide 1 MW of power output capacity.

The tender for the main **telecommunications** project to upgrade and replace the current network by a modern internet-based, backbone infrastructure was still ongoing at the end of the review period. Technical assistance was contracted to help the Turkish Cypriot beneficiary 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.

The Organizational Audit of the **Road Safety** Committee was finalized in July 2008. The main outcome was the production of a set of options for restructuring the Committee with a view to enhancing capacity to face the challenges of

³ Additional meetings for the other five areas were held in the first semester of 2009.

approximation with the EU standards in the field of Road Safety. Several procurement tenders were launched for the improvement of the Accident Information System, for the improvement of vehicle inspection and of driving licence exams, for the improvement of traffic operational management and for the improvement of the primary road network.

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

A **Rural Development Support Team** (RDST) was set up in June 2006 after four months delay due to legal action against the Commission by an unsuccessful tenderer. The main task of the RDST was to help prepare a rural development plan to set priorities for a €5 million grant scheme to improve agricultural production. 26 pilot grant contracts were signed for over €0.5 million to improve hygiene on sheep and goat farms. In addition, a €5 million grant scheme was launched aimed at improving living conditions in rural villages. The RDST provided extensive assistance to potential grant applicants. A dedicated Programme Management Unit has been established to assist the Commission with the assessment of grant scheme applications, as well as to assist the selected beneficiaries with project implementation. Technical Assistance teams have been contracted in the crop and animal production sectors to develop farm extension services and improve the capacity of veterinary services.

Two calls for proposals for **schools** were launched in 2008. 13 schools were awarded a grant under the first call. Commissioner Figel visited one of these schools in December 2008. As part of their project, three schools visited counterparts in Hungary, Finland and Germany. Technical assistance was provided for the ongoing reform of the primary and secondary education sector. Co-operation with the European Training Foundation continued and resulted in the launch of an Education Development Platform in September 2008.

To support **life-long learning, social inclusion and active labour market** measures, two calls for proposals were launched with 11 grants awarded. Upgrading of urban and local infrastructure is being undertaken in joint management with UNDP. Works on the restoration of the *Bedestan* building in the walled city of Nicosia continued. Projects to complete local infrastructure were completed in the villages of Kalevaç/Kalyvakia and Hisarköy/Kampyli. Good progress has been made on preparing the rehabilitation works for the Desdemona area within the walled city of Famagusta.

Activities in the "**Micro and small enterprise loan programme**" were focused on the negotiation of a €9 million agreement with *Kreditanstalt für Wiederaufbau* (KfW), following a positive audit of the bank's capacity to implement activities under an indirect centralized management procedure. Sustainable economic development activities focused on the preparation, launch and evaluation of a €800,000 grant scheme for Turkish Cypriot SMEs to improve their competitiveness. The priorities of the scheme were on the provision of help to SMEs, to prepare for implementation of the *acquis* in case of reunification.

The project *Support for **Private Sector Development*** is implemented in joint management with UNDP. A grant scheme of some €600,000 to assist Turkish

Cypriot small companies in developing e-commerce platforms was launched and 29 companies were selected to benefit from this assistance.

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

- (1) *Reconciliation, confidence building measures and support to civil society:* focused primarily at strengthening civil society organizations. A first grant scheme “Cypriot Civil Society in Action I” with a €2 million budget was evaluated and 15 projects were selected. A second grant scheme “Cypriot Civil Society in Action II” was launched with a budget of €2.5 million for which proposals received were still under evaluation in December 2008. The Civil Society Support Team (technical assistance team) provided guidance and support to applicants. It implemented a campaign to raise awareness of the role of civil society and the importance of active citizenship. The campaign was launched in the presence of Commissioner Spidla. Under this project, the EU has provided €1.5 million to the Committee of Missing Persons.
- (2) *Demining:* In total, 20 out of the 26 agreed minefields were expected to be cleared under a €4 million contract. A further €5 million is needed to clear the buffer zone completely of mines by the end of 2010.
- (3) *History teaching project:* Council of Europe delayed countersignature of a €1 million contract on history teaching because of concerns expressed by the Republic of Cyprus authorities. The project was subsequently cancelled because it had become obsolete due to developments in the sector.
- (4) *Academy of Political Studies:* the project, 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 two seminars.

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

The Scholarship Programme continued for academic year 2008-2009. 122 scholarships were granted, up from 30 scholarships in the previous year. Turkish Cypriot scholars are studying in the United Kingdom, the Netherlands, France, Finland, Belgium, Germany, Italy, Spain, Estonia and Hungary. The third call was also launched in September for academic year 2009-2010 and the first information sessions, organized in the autumn, showed increasing interest from Turkish Cypriot students.

The first call for proposals, under the “*Promotion of Youth Exchanges and other People-to-People Contacts*” grant scheme, was launched with a budget of €1.5 million. The objective is to help Turkish Cypriots improve their understanding of European values, experiences and multi-cultural traditions. Only seven project proposals were selected. The high rejection rate of project proposals shows the difficulty for individuals to design projects that fit into the overall objectives of this action.

The procurement of a contractor to run the future Information Point in the northern part of Nicosia was delayed due to the difficulty in finding suitable experts for the project.

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

This objective is mainly carried out through the European Commission's Technical Assistance Information Exchange (TAIEX) instrument. In 2008, TAIEX organised 220 activities such as workshops or seminars with 466 experts from EU Member States. Assistance concentrated mainly on the preparation of the Programme for the Future Application of the Acquis (PFAA). The main aim of the PFAA is to provide a framework for the identification and prioritisation of specific areas of the *acquis communautaire* where assistance will be provided in preparation for reunification. The PFAA targeted 12 sectors of the *acquis communautaire*.

Linked to the concerns of the OECD-based Financial Action Task Force (FATF) about the vulnerability to **money laundering and terrorism financing** in the northern part of Cyprus, TAIEX provided assistance concerning international standards and their application. This led to the FATF issuing a public statement in October 2008 stating that the level of vulnerability to money laundering had been significantly reduced. The Commission has agreed to continue to act on behalf of the FATF and to monitor further developments.

In the **environment** sector, assistance was provided to prepare the mapping and designation of six specially protected environmentally sensitive areas; the elaboration of a water strategy; the creation of an inventory of all water boreholes and wells.

Regarding **agricultural policy**, continuous work on a reform strategy paper with an in-depth economic analysis of the agricultural sector focusing on key sectors (dairy, cereals, potato and citrus) as well as concrete proposals for change in the policy was undertaken.

Under the project for capacity building in the **environment** sector, the main activities focused on the development of air quality monitoring and quality assurance systems. The necessary equipment was identified, technical specifications prepared and the tender procedure launched.

The need for improved **statistical** information has also been a key focus of support.

Phytosanitary experts were recruited to supervise potato trade across the Green Line which tripled in 2008 compared to 2007, reaching a value of more than €2 million. Experts also assisted the start of trade in fish and citrus fruit.

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 programme. This covers costs of staff involved in the implementation and costs linked to the Programme Support Office.

4.3. Financial execution (contracts and payments)

4.3.1. Contracting

During the reporting period, a total of €37 million was contracted. Of this, around €31 million was contracted under the operational part of the programme and around €5 million for supporting activities under Article 4(3) of the Aid Regulation.

By the end of 2008 nearly €70 million was contracted in total (27%). Of this amount, around €63 million was contracted under the operational part.

4.3.2. Payments

During the reporting period, the Commission disbursed a sum of around €13 million.

By the end of 2008, the Commission had disbursed, from the programme, a total sum of around €26 million (10%).

4.4. Monitoring

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

4.5. Audit and controls

An internal audit was carried out in 2008 by DG Enlargement Internal Audit Capability Unit. The main recommendations focussed on assuring sound financial management in the specific legal circumstances obtaining in the northern part of Cyprus.

4.6. Information, Publicity and Visibility

During the reporting period, 33 press releases were published on programme-related issues. A total of 23 public events were organized. The Programme Team and the EC Representation used many opportunities to increase the programme's visibility, including the visit of European Commissioners in the northern part of Cyprus. Information campaigns were carried out using mass media, mostly for grant schemes such as the Scholarship Programme. Cooperation with the EC Representation in Cyprus for the dissemination of press releases, media interviews and other actions also contributed to increase visibility. Awareness about the Programme among the Turkish Cypriot community has increased significantly during the reporting period.

4.7. 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. There were eight 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.

As for property rights, there was a significant increase in project preparation in 2008 requiring verification of property ownership. To this end, the Commission requested the support of the Government of the Republic of Cyprus to confirm the names of private owners. 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) Implementation: preparing and revising tender dossiers, calls for proposals for grant schemes, works and services tenders and contracts, as well as supervision of the execution of contracts signed.
- (2) Further strengthening of the Programme Team: to facilitate contracting and programme implementation ten additional staff were employed.

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. Improved cooperation in 2008 facilitated programme implementation.
- (2) 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 a short time. Considerable improvement was noted in the course of 2008.
- (3) Court cases, now withdrawn: caused two to three months of delay in implementation of certain projects.
- (4) Delays concerning property: The time required to identify owners' names and the need to obtain their consent has to fit into the tight implementation schedule. This issue becomes more important as the 2009 contracting deadline approaches.
- (5) Shortage of funds: following the preparation of technical documentation and adjustment of projects there is a significant shortage of funds and it might not

be possible to finance one or more of the planned projects under the currently available funds.