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

**Sixth Annual Report 2011 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 389/2006 establishing an instrument of financial support for encouraging the economic development of the Turkish Cypriot community (TCc)¹ (hereafter the "Aid Regulation") is the basis for the implementation of the assistance to the TCc and requires annual reporting to the Council and the European Parliament. This sixth report covers the year 2011.

2. PROGRAMMING OF THE ASSISTANCE

Between 2006 and 2010, €264 million was programmed under the Aid Regulation and many of the projects arising from this earlier funding were still underway in 2011. Development of the 2011 programme used input from stakeholder consultations and from 2009 and 2010 evaluations. It followed the objectives of the Aid Regulation: reunification of Cyprus through the promotion of social and economic development; reconciliation, confidence building and support to civil society; bringing the TCc closer to the EU and preparation of *acquis*-aligned legal texts for the purpose of these being immediately applicable upon the entry into force of a comprehensive settlement of the Cyprus problem. Finance for infrastructure or large equipment was not included in the 2011 allocation, since substantial infrastructure projects were already underway. The 2011 allocation of €28 million was made available under two Commission Decisions².

3. IMPLEMENTATION MECHANISMS

The programme is implemented in an EU Member State in an area that is not under the effective control of the Member State authorities and where the application of the EU *acquis* is suspended. The 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

¹ OJ L65, 7.3.2006, p.5.

² Commission decisions C(2011)337 and C(2011)4443.

circumstances, a Financing Agreement with the beneficiary Government establishes the legal framework of the assistance. No such agreement exists for the assistance to the TCc. The Commission has to rely on what it understands to be the rules and conditions applicable locally and this introduces a certain level of risk. Management and mitigation of these risks is part of the Commission's responsibility and adopted measures include intensive monitoring and support to beneficiaries, revised payment conditions, linking advance payments with proof of signed procurement contracts and a more widespread use of bank guarantees.

The Commission relies on the support of the TCc to make this programme a success and in particular to ensure its long-term sustainability. TC stakeholders are consulted about their needs for future funding and TC experts take part in tender evaluation committees and play a key role in project steering committees. 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, set up in 2006 within the Commission's Directorate-General for Enlargement, uses the EU Programme Support Office (EUPSO) in the northern part of Nicosia, with office logistics provided through a service contract. This office provides a local base for project implementation and for interaction with TC stakeholders. The Representation of the Commission in Cyprus also hosts meetings and seminars and communicates to the Cypriot public on the programme as part of its standard role.

In the absence of a Financing Agreement to establish the legal framework under which the assistance is implemented, sector development programmes cannot easily be conceived. The assistance programme, therefore, includes a significant amount of grant support, particularly to non-public actors including NGOs, SMEs, farmers and students. Management of this grant assistance (over 1000 grants since 2009) is demanding in terms of EUPSO human resources, and the staffing situation was particularly challenging in 2011, with reduced numbers and a high turnover, requiring strict priority setting.

One challenge of the EU assistance to the TCc is the difficulty of medium and long-term planning. The programme is currently financed from the margins of the EU budget as it is not included in the multi-annual financial framework for 2007-2013 and annual allocations are not guaranteed. There are, however, a number of sectors, including those important for future *acquis* compliance, where multi-annual support is required for intervention to succeed fully.

4. IMPLEMENTATION DURING THE REPORTING PERIOD

4.1. General overview

The year 2011 saw the major supply and large construction contracts from the 2006 programme moving towards completion in water, solid waste, nature protection, energy and telecommunications. Many grant contracts under the various schemes for civil society NGOs, SMEs, rural development, schools, scholarships, and training organisations were completed. Considerable technical assistance (TA) has also been delivered in support of these programmes. Operations through joint management

with UNDP were conducted in support of the Committee on Missing Persons, waste water treatment and upgrading of local and urban infrastructure. The Commission mandate under the Aid Regulation also includes preparation for the full application and implementation of the *acquis communautaire* following a solution to the Cyprus problem and the dissemination of information on the European Union's political and legal order to the TCc. The two years since 2009 have, therefore, been a period of intensive project implementation in which the Commission has developed considerable experience in dealing with local constraints. Despite the fact that some major infrastructure is close to the point of hand-over to the beneficiary, there continue to be problems of project sustainability. Works contracts for the seawater desalination plant near Sirianokhori/Kumköy and the construction of nature protection facilities in four Special Environmental Protection Areas, defined as potential *Natura 2000* sites, had to be cancelled by the Commission.

One further problem that arose in 2011 was the status of bank guarantees issued in the northern part of Cyprus. One local contractor filed a suit with the local "court" to prevent the Commission from calling advance and performance guarantees after a contract termination. This matter is of relevance to the programme in general and, until the matter is resolved, concerns about the effectiveness of local bank guarantees will remain.

4.2. Progress by objectives

The overall objective of the Aid Programme is to facilitate the reunification of Cyprus by encouraging the 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 of the implementation of EU law in case of a comprehensive settlement of the Cyprus problem. A considerable contribution has been made towards improvements in some areas, notably water, waste water and environment, and there is some evidence that the GDP/capita gap between the government controlled areas and the northern part of Cyprus has been reduced, although the picture is not entirely clear due to incomplete data.

4.2.1. Objective 1: Developing and restructuring of infrastructure

In the water sector, the replacement of old, concrete asbestos water distribution pipes in the northern part of Nicosia, Kyrenia, Kioneli/Gonyeli and Lefka /Lefke was completed during 2011. In Nicosia, the beneficiary has reported a substantial reduction in leakages, resulting in overall water supply to the northern part of Nicosia falling from 0.67 to 0.40 m³/day/consumer meter.

In the Morphou/Güzelyurt area, the commissioning of the wastewater treatment plant was started during the second half of 2011. In addition, 53 km of sewerage network and 43 km of water main were installed. After all house connections have been made, this will provide, for the first time, wastewater collection and treatment in this region for about 10,700 people thereby reducing pollution of groundwater sources. In the Famagusta area, the new wastewater treatment infrastructure for about 30,000 people is nearing completion and will be commissioned during the first half of 2012. The project includes 50 km sewerage network and 45 km water network. Both projects in Famagusta and Morphou have suffered from construction delays, putting a strain on the limited supervision resources. The construction of the new Nicosia bi-

communal wastewater treatment plant at Mia Milia/Haspolat, co-funded by the EU and the Sewerage Board of Nicosia and implemented through the UNDP, continued in 2011 and commissioning is expected in the second half of 2012.

The largest project in the water sector was the €27 million seawater desalination plant at Sirianokhori/Kumköy, to supply water to 100,000 people and reduce the overexploitation of the Morphou aquifer, which is the current main water source in the area. The programme experienced problems including site access restrictions imposed by the Turkish army, which emerged at the end of 2010. Once those restrictions were lifted in March 2011, the contractor was unwilling to continue. The Commission terminated the contract in December 2011.

On *nature protection*, draft management plans were prepared for all Special Environmental Protection Areas (SEPAs) and consultation meetings were held with local stakeholders. A walking trail network of over 600 km was completed. Construction of information and management centres located in four SEPAs suffered from poor contractor performance and the Commission terminated the contract in November 2011. The place of arbitration of the contract is Belgium, but the local TC contractor filed a suit with the local "court" to prevent the Commission from calling the advance and performance guarantees from the local bank. Until the matter is resolved, concerns about the effectiveness of local bank guarantees will remain. The completion of the buildings remains a challenge to be addressed in 2012. In the meantime, the delivery and use of supplies intended for the nature protection teams has been delayed.

With regard to *solid waste*, the rehabilitation and closure of the Kato Dhikomo/Aşağı Dikmen dump progressed well and will be completed in the first half of 2012. The transfer station in Famagusta and the new landfill in Koutsoventis/Güngör were completed in 2011. The handover and opening of the new facilities was, however, delayed because the beneficiary has not been able to put in place the necessary operating entity. Delays have also arisen from a local "court" case pursued by a nearby university on environmental grounds. The case has been dismissed by the "court", but this has led, in the meantime, to temporary dumping on a new area close to the Kato Dhikomo/Aşağı Dikmen site. The medical waste facility for the main hospital in the northern part of Nicosia was handed over at the end of 2011.

In the *energy* sector, the remaining supply and TA contracts have been completed. The challenging construction of the 1.27 MW Solar Power Plant was finished and the installation has been running at full power since November 2011. The allocation of dedicated staff by the beneficiary is necessary, however, for the effective and sustainable use of the generating installation and the control system. The TA for the restructuring of the electricity utility and the sector policy reform was not delivered effectively due to a lack of cooperation from the counterparts.

In the *telecommunications* sector, all equipment for network upgrading has been delivered to the sites and most of it has been installed, but there have been delays in site preparation and technical input by the beneficiary. The project should be completed by mid-2012. The TA component has been extended accordingly. The "law" detailing the modalities of liberalisation of the electronic communications sector was adopted in December 2011. The conditions necessary to separate the

provision of services from the network operation are still to be met in order to ensure a smooth transfer and a sustainable use of the EU-financed assets.

Under the *traffic safety* project, all TA and supply projects are finished. Traffic management plans have been prepared, the accident information database and the data collection system are effective and the vehicle inspection equipment has been installed and is in use. The education campaign to promote traffic safety took place at the beginning of 2011 and has demonstrated some immediate, positive results with a significant reduction in the number of severe accidents. Finally, after several delays, the project to eliminate traffic accident “black spots” should be completed within the first half of 2012.

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

Four TA teams continued to deliver training and assistance to farmers, veterinarians and rural development counterparts including support for grant implementation. The two grant schemes *Improving Agricultural Production* and *Supporting Rural Enterprise* were completed in 2011, but many of the 37 projects under *Community Development through Village Initiatives* suffered delays, arising in particular from procurement of infrastructure works. Two additional Calls for Proposals, to be funded under 2011 budget, were prepared.

Under the project *Upgrading of Urban and Local Infrastructure* implemented under joint management with UNDP, rehabilitation works in several villages in the northern part of Cyprus (Louroukina/Akincilar, Tremetousia/Erdeмли, Galinoporni/Kaleburnu and Kormakitis/Kormacit) were finalised. Renovation of the market in the northern part of the walled city of Nicosia has continued and will be completed in 2012.

The TA activities for the *Ongoing Reform of Primary and Secondary Education* continued to focus on building the capacity of the main stakeholders including intensive training of a core team of inspectors, study visits, training and support for child-centred education, development of quality standards and input for the development of the European Information Management System. The project ended in December 2011. The main output was a draft vision and mission document for the education sector in the northern part of Cyprus. Most of the 72 grant contracts signed with local schools finished in 2011. Only seven will continue into 2012.

TA was provided for the development of *Vocational Education and Training Systems, Life-Long Learning and Active Labour Market Measures*, including the opening of a job centre in Nicosia, study visits and conferences abroad. Efforts were concentrated on training the stakeholders in areas such as entrepreneurship and career counseling and collaboration with local counterparts has been very productive. The project ended in February 2012. Under the project for *Life-Long Learning, Social Inclusion and Active Labour Market Measures*, 31 grants have been awarded to SMEs, Chambers of Commerce and other training organizations since 2008. Most were completed in 2011 and only two will continue into 2012.

In support of *SME Competitiveness*, 23 grant contracts were ongoing during 2011. There have been delays due to lack of experience of EU grants by SME beneficiaries, but all the contracts will end in 2012. The private sector has also received TA

support promoting good business practices. A significant result was the adoption of a *Private Sector Development Strategy* by the TCc. Sector-specific marketing initiatives were also undertaken to promote local products in Nicosia and Famagusta. Training in entrepreneurship and project cycle management started in 2011 and will continue in 2012. In the ICT sector, help was given to develop an e-governance strategy.

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

Support to the *Committee on Missing Persons* for exhumation, identification and return of remains, managed jointly with UNDP, is ongoing. Work now focuses more on individual exhumations rather than mass exhumations and this has influenced the speed of the process. A new Contribution Agreement with UNDP, continuing the work, is likely to be signed in 2012.

The *demining* of the buffer-zone has been almost completed. There is lack of agreement on access to remaining minefields in the buffer zone or extension of demining to areas outside the buffer zone hampering the continuation of EU funded demining activities. A final evaluation of the project was positive, highlighting the appreciation of the project by all stakeholders.

Out of the 44 projects under three grant schemes so far for *Civil Society in Action*, 27 have been concluded or are near completion. Ten projects will end their activities in 2012. A TA team provided guidance to applicants on grant management. More training will be necessary to accompany the next grant call in 2012, since grant beneficiaries' capacity for producing good quality applications for EU grants and for grant administration and activity reporting is proving insufficient in many cases.

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

For the fifth year of the Scholarships Programme, 89 scholarships (9 teachers, 1 undergraduate, 79 graduates) were granted, with free choice of study or training programme, although with priority given to technical and administrative topics where there is a skill shortage in the TCc. An evaluation of the scholarship scheme will be carried out in 2012.

Visibility was mainly ensured by the *Infopoint* project and 2011 was a fruitful year with 37 events. The biggest EU-funded event was organised in collaboration with the TC Children's Welfare Association and attracted around 1000 participants. In addition, video clips and photo archives were prepared and there were two academic conferences organised with the participation of internationally renowned scholars and local Turkish Cypriot and Greek Cypriot academics. There were also eight issues of the Infopoint Newsbulletin published in Turkish and one in English covering the Aid Programme and current EU topics.

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

The Commission's TA Information Exchange (TAIEX) instrument helps prepare the TCc for implementation of the EU *acquis* following the settlement of the Cyprus

problem. TAIEX supports the preparation of *acquis*-compliant legal drafts, which are then subject to review and approval through the local processes. Through TAIEX, over 80 EU experts carried out 528 actions in 2011, including training courses, workshops, and study visits. Activities followed the *Programme for the Future Application of the Acquis* (PFAA), which provides the medium-term framework for the intervention. In addition to the 13 sectors of the PFAA, assistance was provided in 2011 in Free Movement of Goods, Intellectual Property Rights and Mutual Recognition of Professional Qualifications. Linked to the future management of EU funds after a settlement, training was also given on Public Expenditure Management. Finally, trade across the Green Line (Regulation 866/ 2004) was also supported by TAIEX EU Member State experts who were mobilised to carry out regular phytosanitary/veterinary inspections of potatoes and fish. Preparations for a new cycle of TAIEX assistance were launched at the end of 2011 in cooperation with the beneficiaries.

The equipment supplied in previous years under contracts for air quality monitoring is in use. The two TA contracts for this sector have ended. The equipment supports compliance to the new draft environment "law". Sustainability requires a commitment to staffing and to equipment servicing in the long run.

The progress of draft "legislation" aimed at *acquis*-alignment through the approval process was, however, slower than hoped. The telecommunications reform "law" was finally adopted at the end of 2011, but the environment "law" has been delayed.

4.2.6. *Other projects*

A €1 million Trust Fund with the World Bank to carry an *Economic Analysis Programme for Growth and Sustainable Development* was restarted in 2011 and a Stock-Taking Report was delivered in December.

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

4.3.1. *Contracting*

Commitments in 2011 were €7.45 million (66% of the January forecast of €11.2 million). Commitments for school grants and a Contribution Agreement with UNDP in the field of Cultural Heritage were delayed until 2012.

4.3.2. *Payments*

Payments in 2011 totalled €49.98 million (67% of the January forecast). During the year, however, the target was reassessed and reduced by €24.5 million. This was due to the termination of two works projects, delays in large scale projects in the field of water and telecommunications and to late completion of grant projects, particularly those dealing with village upgrading. From the revised projection, 100% was disbursed.

In total, €179 million (69% of the overall amount contracted since the start of the programme in 2006) was disbursed by the end of 2011. The number of contracts open at the end of 2011 was 533.

4.4. Monitoring

The bi-annual Interim Review Mechanism (IRM) serves as a forum for detailed discussion of the programme with the beneficiaries. EC staff also carries out continuous monitoring through field visits, site meetings and Project Steering Committee meetings. TAIEX activities are monitored through more than 20 Project Steering Groups, that each met twice in 2011, plus bi-annual Monitoring Mechanism meetings. TAIEX logistics are monitored through the on-line TAIEX Management System. In most of the intervention areas, a lack of beneficiary experience or capacity causes implementation difficulties or delays. Grant beneficiaries, for example, experienced problems with EU procedures, particularly for procurements using grant funds. This has been addressed through Project Management Units, established to assist grant holders with grant administration. In the case of infrastructure or supply projects, the central or local TC administration, which will be responsible for operation and maintenance, is struggling to provide adequate resources and set up suitable structures in a number of cases. Appropriate TA is provided to support the beneficiary through the hand-over period.

4.5. Audit and controls

The European Court of Auditors carried out a performance audit in 2011. The report will be published in 2012.

The ELARG Internal Audit Capability Audit Report of 2008 was supplemented by a 2011 follow-up that concluded that all recommendations have now been implemented, although some residual risk has been identified in handing over of works and supplies.

An ex-post control was carried out at the end of 2010 by the Operational Audit & Evaluation Unit of DG ELARG to verify legality and regularity of a set of 23 transactions. The final report in May 2011 made some observations on procedures, which are being considered.

An external audit was carried out on 12 selected grant contracts and the final report will be delivered in the first half of 2012.

4.6. Evaluation

A review of the water sector was initiated in 2011 and will contribute to future programming. A World Bank study of economic aspects of the TC economy was also underway in 2011. A major evaluation effort has been foreseen for 2012, when the main part of the 2006 programme will finish.

4.7. Information, Publicity and Visibility

Visibility was ensured through the *Infopoint* (see Objective 4). In addition, TA teams from the separate projects have been tasked with enhancing visibility. A number of project-completion events were also held by grant beneficiaries. Six press releases relating to 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 also meets regularly with the Permanent Representation in Brussels. The Commission continues to rely on the cooperation of the Government of the Republic of Cyprus for verification of property ownership.

5. CONCLUSIONS

The programme continues to meet challenges in its implementation, in the absence of a recognised beneficiary or a programme for direct institutional restructuring. Progress towards meeting the objective of the Regulation to *facilitate the reunification of Cyprus by encouraging the economic development of the Turkish Cypriot community* remains difficult to achieve, given the operating environment and the sui generis political and economic situation prevailing in the northern part of Cyprus. The process of preparing for the future adoption and implementation of the *acquis* is slow and the TCc is likely to require considerable support to meet *acquis* requirements in many areas following a settlement and reunification.

During the reporting period, activities focused on the completion of the 2006 programme. A number of substantial infrastructure and equipment supply projects were nearing completion. The Morphou waste water treatment plant started to receive wastewater and the pilot solar power plant, completed and handed over in July, is operating at full capacity. Efforts have been made to prepare the beneficiary for handover and future operation, but lack of resources and experience mean that substantial further commitment and input is required from the TC administration to ensure sustainability of the investments. Inefficient structures and unclear responsibilities are the underlying causes in many cases. This must be addressed in 2012.

The many grant schemes launched since 2009 have been well received, but have been demanding in terms of human resources, partly because of lack of experience of the beneficiaries for project and financial management.

As the major part of the 2006 programme is completed, an overall review evaluation of the Aid Programme, as well as sector-specific impact studies are necessary and will be carried out in 2012.

Human resources for the Programme Team remain a challenge, partly because of the grant-intensive programme composition, but also because of the overall reduction in human resources foreseen in all services of the Commission.

The programme would benefit from more medium and long term planning for which more stable arrangements for financing the operational and staffing costs are necessary.