

Instrument of financial support for encouraging the economic development of the Turkish Cypriot community

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The Commission presents its sixth annual report, covering the year 2011, on the implementation of Community assistance under Council Regulation (EC) No 389/2006 ('the Aid Regulation') establishing an instrument of financial support for encouraging the economic development of the Turkish Cypriot community.

The report recalls that between 2006 and 2010, EUR 264 million was programmed under the Aid Regulation and many of the projects arising from this earlier funding were still underway in 2011. The 2011 allocation of EUR 28 million was made available under two Commission Decisions.

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

Implementation: the report notes that 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 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, a Financing Agreement with the beneficiary Government establishes the legal framework of the assistance. No such agreement exists for the assistance to the Turkish Cypriot community. 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**.

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.

Financing: one challenge of the EU assistance to the Turkish Cypriot community 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**.

Projects: 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. The **Morphou wastewater 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 Turkish Cypriot 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.

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**.

The report concludes that 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 Turkish Cypriot community is likely to require considerable support to meet acquis requirements in many areas following a settlement and reunification.

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.