



CY - Economic
analysis for
growth
(71410)

ADDENDUM NO 2

**TO THE
ADMINISTRATION AGREEMENT FOR THE EUROPEAN UNION CONTRIBUTIONS,
AS REPRESENTED BY THE EUROPEAN COMMISSION, TO TRUST FUNDS**

**World Bank Group Trust Fund No TF071410
"Economic Analysis Programme for Growth and Sustainable Development"
European Commission Trust Fund No 2009/217-942**

The European Union, represented by the European Commission, B-1049 Brussels, Belgium, in order to support the economic development of the Turkish Cypriot community, in accordance with Council Regulation 389/2006 (OJ [2006] L 65/5) (the "European Commission")

of the one part,

and

The World Bank, Europe and Central Asia Region, H12-1202, 600-19th Street, NW, Washington, DC 20433 (the "World Bank")

of the other part,

have agreed as follows:

The following provisions of the Administration Agreement No 2009/217-942 "Economic Analysis Programme for Growth and Sustainable Development" concluded between the European Commission and the World Bank on 14/12/2009 (the "Agreement") are hereby replaced as follows:

Article 2. Entry into force and Implementation Period

Section 2.03. It is expected that the Contribution will be fully utilized in accordance with the provisions of this Administration Agreement by **December 15, 2013** ("End Disbursement Date"). The End Disbursement Date can only be modified with the agreement of both Parties pursuant to Article 9 of the General Conditions.

Article 6. Annexes

Section 6.01 The new versions of Annex I "Description of the Project" is attached to this addendum.

All other terms and conditions of the Administration Agreement and its previous addenda remain unchanged. This addendum shall form an integral part of the Administration Agreement and it shall enter into force on the later date of signature by the Parties.

This addendum is drawn up in three originals, two for the Commission and one for the World Bank.

For the World Bank:

Name: Helga Muller

Acting Director, Strategy
Position: ad operations, CCAVP

Signature:



Date: 8/10/2012

For the European Commission:

Name: Michaela DI BUCCI

Position: Head of Unit 02 – Task Force Turkish
Cypriot community

Signature:



Date:

13/7/2012

ANNEX I OF THE ADMINISTRATION AGREEMENT
DESCRIPTION OF ACTIVITIES AND EXPENDITURES
UNDER THE TRUST FUND

DESCRIPTION OF THE PROJECT

The following is a description of the activities to be carried out under the trust fund, subject to such minor modifications as the Commission and the Bank may mutually agree from time to time by notice in writing provided that such modifications do not materially affect the scope of the activities and the objectives of the Project.

Title

Economic Analysis Programme for Growth and Sustainable Development

Location

Northern part of Cyprus

Cost of the Action and Contribution from the Contracting Authority

Total eligible cost of the action	Total contribution from the Contracting Authority
EUR 1,000,000	EUR 1,000,000

Summary

Duration of the action	It is expected that the Contribution will be fully utilized in accordance with the provisions of this <i>Administration Agreement</i> by the End Disbursement Date.
Objectives of the action	<p>Overall objective:</p> <p>The overall objective is to assist with the development process to further economic convergence within Cyprus in view of the integration of the Cyprus economy and the ongoing talks on reunification.</p> <p>Specific objectives:</p> <ul style="list-style-type: none"> ○ To fill knowledge gaps of macroeconomic developments in the northern part of Cyprus; ○ To elaborate for the Turkish Cypriot economy a reform

	<p>agenda for selected priority areas based upon economic and sector analyses;</p> <ul style="list-style-type: none"> ○ To enhance local understanding of constraints impeding development and reforms through intensive outreach and consultation.
Target groups	Decision makers and civil society in the Turkish Cypriot community and Greek Cypriot community
Final beneficiaries	Turkish Cypriot community and Greek Cypriot community
Main activities / estimated results	<ul style="list-style-type: none"> ○ Stocktaking of macroeconomic and structural developments (1 report) ○ Macroeconomic monitoring (4 reports) ○ Macromodeling (1 report) ○ Public Expenditure Review (1 report) ○ Financial Sector Review (1 report) ○ Competitiveness study (1 report) ○ Policy Notes (4 notes)

Objectives of the Programme

The Economic Analysis Programme for Growth and Sustainable Development is being funded through the aid regulation “Council Regulation (EC) No. 389/2006” of 27 February 2006. The first stated overall objective of the aid regulation is that “[t]he Community shall provide assistance 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*”.

The overall objective of the Economic Analysis Programme for Growth and Sustainable Development is to assist with the development process to further economic convergence within Cyprus, with particular emphasis on the economic integration and having regard to the discussions on reunification. In this context, the specific objectives of the programme are to: (i) Fill knowledge gaps of macroeconomic developments in the northern part of Cyprus; (ii) Elaborate for the Turkish Cypriot economy, a reform agenda for selected priority areas based upon economic and sector analyses; and (iii) Enhance local understanding of constraints impeding development and reforms through intensive outreach and consultation.

Scope of the Programme and Description of Activities

The scope of the analytical economic programme proposed is as follows:

Stocktaking of macroeconomic and structural developments

An overview of economic developments in the northern part of Cyprus over the last three years will be carried out to provide the economic context in which the economic and sector

work ESW) programme will be carried out. The report relies upon available data. Furthermore, the stocktaking exercise provides a basis for discussions on the economy and the discussion of the elements of a meaningful reform agenda. Consequently, the main issues impacting growth will be covered including public finance and private sector development.

Macroeconomic monitoring

This part of the analytical program has three components. The first is the construction of an integrated, “what if,” computable general equilibrium or agent-based model that will be used to study various policy reform issues, including the effects on the economy of further economic integration of the island. The second will be a macroeconomic review that utilizes the outputs from the macro model and data from other sources to provide recommendations for policy action on important macroeconomic issues. This report will include analytical results from the macro model regarding the economic effects of various plausible scenarios concerning further economic integration of Cyprus. The third component would be to provide a semi-annual update on economic growth, prices and exchange rates, external sector, and the general public sector budget. If feasible, any regulatory changes with a significant economic impact will also be highlighted. The macroeconomic monitoring notes are primarily descriptive in nature and will not involve new analytical work.

Public Expenditure Review (PER)

The PER will analyze the public finance management system, especially in the face of annual deficits. Particular attention will also be paid to requirements for restructuring fiscal management to accord with the requirements of the *acquis*. In broad terms, the PER will undertake the analysis of the following topics: (1) on the side of expenditures, assistance will be provided on expenditure management which has the objective of increasing compatibility with requirements of the *acquis*; (ii) restructuring revenue raising to reduce incompatibility with the *acquis*; (iii) stocktaking of non-financial public enterprises and the fiscal burden and (iv) sustainability of the pension system.

Financial Sector Review

One of the primary objectives of the financial sector review will be the development of actionable recommendations for the reform of the financial sector in the northern part of Cyprus. To ensure the medium-term stability of the economy’s financial system, it will be important to determine what the strains on the financial sector are and whether any particular aspects of it need to be strengthened at an institutional level or at the policy level. The main components of the financial sector review will focus on the banking sector. Five areas of analysis will provide the focal point of this exercise: (i) systemic and solvency analysis which includes stress testing, analysis of financial soundness indicators, and macrofinancial linkages; (ii) analysis of financial sector structure covering the characteristics of efficiency, competitiveness, concentration, and liquidation; (iii) assessment of observance and implementation of relevant international standards, codes, and good practices; (iv) analysis of specific stability and development issues tailored to economy circumstances and (v) assessment of asset and/or liquidity position of specific institutions. It should be noted that if the IMF conducts a similar study, this activity will be excluded from this exercise to avoid duplication.

Competitiveness

In view of the integration of the economy of Cyprus, the ongoing talks on reunification, and the need to increase opportunities for employment, this study will: (i) identify policy areas to promote greater economic dynamism and enhance competitiveness. Analysis will focus on

policies affecting the supply-side sources of growth – labour, capital investment, and total factor productivity. The objective is to find measures to foster greater private sector employment, enhance capital investment, and raise productivity to improve conditions for reunification and to accelerate income convergence between the Turkish Cypriot and Greek Cypriot communities. A better understanding of these issues and the trade integration analysis in (iii) below will also be important in the context of the eventual application of the *acquis*'s four freedoms – movement of labour, capital, goods, and services. (ii) Elaborate a strategy for institutional strengthening to improve public-private sector consultation. The goal is to find ways to enhance the provision of public inputs to existing private sector activities with the aim to improve productivity and product quality. (iii) Identify barriers to expanding international trade integration. The goal is to assess the impact of the current foreign trade regime and important aspects of the business climate on the volume and pattern of trade with a view toward improving the conditions for trade expansion in response to reunification and an enlarged opening to EU markets.

Policy Notes

The economic analytical programme will include four policy notes which will be short documents that answer specific questions by providing an economic analysis and relevant international experience. These policy notes can be especially useful for analysing the economic impact of specific reforms. The policy notes will be characterized by both the specificity of the topic as well as the resources devoted to the product.

Team Proposed for the Implementation

It is anticipated that the team will be led by Sarosh Sattar under the supervision of Yvonne Tsikata (Sector Director), Benu Bidani (Sector Manager), and Theodore Ahlers (acting Country Director for Cyprus). The team leaders of the individual studies will include Thomas Laursen and Karlis Smits (public finance), John Pollner (financial sector), Ruslan Piontkivsky (macroeconomic monitoring), and Sarosh Sattar (private sector development). Additional World Bank staff and consultants will be identified to participate in various tasks. The World Bank may change the personnel assigned to the supervision or the team, as required.

Timetable of Activities

The programme will be implemented over two years. The estimated dates of the submission of the draft reports for review to the EU from the World Bank are as follows:

- o Stocktaking of macroeconomic and structural developments (October 2011);
- o Macroeconomic monitoring, semi-annual basis (January 2012, July 2012, and January 2013, July 2013);
- o Macro modelling (November 2013)
- o Financial Sector Review (April 2012);
- o Public Expenditure Review (May 2012);
- o Global Competitiveness study (March 2013);
- o Policy note series (4 notes) (unspecified timetable during January 2012 – December 2013)