



**NATIONAL LISBON
PROGRAMME OF THE
REPUBLIC OF CYPRUS**



OCTOBER 2005

NATIONAL LISBON PROGRAMME OF CYPRUS

CONTENTS

I. INTRODUCTION

II. OVERALL STRATEGIC APPROACH AND KEY CHALLENGES

III. MACROECONOMIC CHALLENGES

A. Macroeconomic Situation

B. Macroeconomic Challenges

1. Securing Stability for Sustained Growth through Fiscal Consolidation (Guidelines 1 and 3)
 - 1.1. Policy Priorities
 - 1.2. Policy Initiatives
 - 1.2.1. Fiscal Adjustment and Debt Reduction
 - 1.2.2. Composition of Government Expenditure
 - 1.2.3. Tax Policy
 - 1.2.4. Fiscal Management, Transparency and Good Governance
2. Safeguarding Economic and Fiscal Sustainability as a Basis for Increased Employment and Promoting Greater Coherence Between Macroeconomic, Structural and Employment Policies (Guidelines 2 and 5)
 - 2.1. Policy Priorities
 - 2.2. Policy Initiatives
 - 2.2.1. Increasing Labour Market Participation and Expanding the Labour Supply
 - 2.2.2. Reform of Social Insurance and Health Care Systems
3. Ensuring that Wage Developments Contribute to Macroeconomic Stability and Growth (Guideline 4)

IV. MICROECONOMIC CHALLENGES

1. Promotion of the further Diversification of the Economy towards the Production of High Value Added Goods and Services – Strengthening the Competitive Advantages of its Production Base
 - 1.1. Current Situation
 - 1.2. Policy Priorities
 - 1.3. Policy Initiatives
 - 1.3.1. Further Promotion of the Restructuring and Diversification of the Economy towards the Production of High Value Added Goods and Services
 - 1.3.2. Upgrading and Enriching the Tourist Product
 - 1.3.3. Enhancement of the Competitiveness of the Manufacturing Sector
 - 1.3.4. Enhancement of the Production Base of Disadvantaged Areas

2. Promotion of R&D, Innovation and Facilitation of ICT Diffusion
 - 2.1. Increase and Improve Investment in R&D, in particular by Private Business
 - 2.1.1. Current Situation
 - 2.1.2. Challenges – Policy Priorities
 - 2.1.3. Policy Initiatives
 - 2.1.3.1. Horizontal Measures
 - 2.1.3.2. Strengthening the Scientific Base
 - 2.1.3.3. Reinforcement of Private Sector Participation in R&D
 - 2.1.3.4. Enhancement of Human Resources
 - 2.1.3.5. Promotion of International Cooperation
 - 2.2. Facilitate All Forms of Innovation
 - 2.2.1. Current Situation
 - 2.2.2. Challenges – Policy Priorities
 - 2.2.3. Policy Initiatives
 - 2.2.3.1. Creation of Innovation Poles and Incubators
 - 2.2.3.2. Provision of Innovation Support Services
 - 2.2.3.3. Improved Access to Finance and Foreign Direct Investment
 - 2.3. Facilitate the Spread and Effective Use of ICT and Build a Fully Inclusive Information Society
 - 2.3.1. Current Situation
 - 2.3.2. Policy Priorities
 - 2.3.3. Policy Initiatives
 - 2.3.3.1. Horizontal Measures
 - 2.3.3.2. eGovernment
 - 2.3.3.3. eBusiness
 - 2.3.3.4. Inclusion (e-Learning, Life-long Learning, Electronic Literacy)
 - 2.3.3.5. Quality of Life (e-Health)
 - 2.3.3.6. Expansion of Broadband Access and Network
3. Promotion of Structural Reforms Targeting at Enhancing Competition and Improving the Overall Business Climate
 - 3.1. Further Enhancement of the Conditions of Competition
 - 3.1.1. Current Situation
 - 3.1.1.1. Utilities Sectors
 - 3.1.1.1.1. Telecommunications and Postal Services
 - 3.1.1.1.2. Electricity Sector
 - 3.1.1.1.3. Air Transport Sector
 - 3.1.2. Policy Priorities
 - 3.1.3. Policy Initiatives
 - 3.1.3.1. Horizontal Measures
 - 3.1.3.2. Telecommunications
 - 3.1.3.3. Energy Sector

- 3.2. Change of the Status of the Organizations in the Utilities Sectors
 - 3.2.1. Current Situation
 - 3.2.2. Policy Priorities
 - 3.2.3. Policy Initiatives
 - 3.2.3.1. Telecommunications Sector
 - 3.2.3.2. Postal Services
- 3.3. Increase the Efficiency of the Public Sector
 - 3.3.1. Current Situation
 - 3.3.2. Policy Priorities
 - 3.3.3. Policy Initiatives
- 3.4. Reduction of the Regulatory and Administrative Burden
 - 3.4.1. Current Situation
 - 3.4.2. Policy Priorities
 - 3.4.3. Policy Initiatives
- 3.5. Rationalisation of State-aid
 - 3.5.1. Current Situation
 - 3.5.2. Policy Priorities
 - 3.5.3. Policy Initiatives
- 4. Expansion and Upgrading of Basic Infrastructures
 - 4.1. Transport
 - 4.1.1. Road Transport
 - 4.1.1.1. Current Situation
 - 4.1.1.2. Policy Priorities
 - 4.1.1.3. Policy Initiatives
 - 4.1.2. Ports
 - 4.1.2.1. Current Situation
 - 4.1.2.2. Policy Priorities
 - 4.1.2.3. Policy Initiatives
 - 4.1.3. Airports
 - 4.1.3.1. Current Situation
 - 4.1.3.2. Policy Priorities
 - 4.1.3.3. Policy Initiatives
 - 4.2. Energy
 - 4.2.1. Current Situation
 - 4.2.2. Policy Priorities
 - 4.2.3. Policy Initiatives

5. Environmental Sustainability
 - 5.1. Current Situation
 - 5.2. Policy Priorities
 - 5.3. Policy Initiatives
 - 5.3.1. Creation / Expansion of the Environmental Infrastructure for a Sustainable Management of Resources and Waste
 - 5.3.1.1. Urban Wastewater Treatment
 - 5.3.1.2. Solid Waste
 - 5.3.1.3. Hazardous Wastes
 - 5.3.1.4. Packaging Waste
 - 5.3.2. Protection, Preservation and Management of Coastal Areas
 - 5.3.3. Promotion of Energy Saving and Renewable Energy Sources
 - 5.3.4. Reduction of Greenhouse Gases Emissions
 - 5.3.5. Internalization of External Environmental Costs

V. EMPLOYMENT CHALLENGES

- A. Introduction
- B. Challenges / National Targets in relation to the European Employment Strategy (EES)
 1. Maintain High Rates of Increase of Labour Supply
 - 1.1. Current Situation
 - 1.2. Policy Priorities
 - 1.3. Policy Initiatives
 - 1.3.1. Increasing Female Participation
 - 1.3.2. Gender Equality
 - 1.3.3. Active Ageing
 - 1.3.4. Build Employment Pathways for Young People
 - 1.3.5. Build Employment Pathways for the Unemployed
 2. Increase the Flexibility in the Labour Market
 - 2.1. Current Situation
 - 2.2. Policy Priorities
 - 2.3. Policy Initiatives
 - 2.3.1. Enhancement and Modernisation of the Public Employment Services (PES)
 - 2.3.2. Promotion of Flexible Forms of Employment
 - 2.3.3. Ongoing Assessment of the Economy's Labour Market Needs
 3. Orderly Management of Economic Migration Issues to Serve the Economic and Social Needs of the Country
 - 3.1. Current Situation
 - 3.2. Policy Priorities

- 3.3. Policy Initiatives
- 4. Further Development of Human Capital
 - 4.1. Current Situation
 - 4.1.1. Formal Education
 - 4.1.2. Training
 - 4.1.2.1. Initial Training
 - 4.1.2.2. Continuing Education and Training
 - 4.2. Policy Priorities
 - 4.3. Policy Initiatives
 - 4.3.1. Continuous Improvement of the Quality of Education at all Levels
 - 4.3.2. Increase Opportunities for University Studies in Cyprus
 - 4.3.3. Continuous Upgrading of Skills to Labour Market Needs
 - 4.3.3.1. Secondary Technical and Vocational Education (STVE)
 - 4.3.3.2. Apprenticeship Scheme
 - 4.3.3.3. Upgrading of Training
 - 4.3.4. Development of a Comprehensive Life-Long Learning Strategy
- 5. Enhance the Conditions of Social Cohesion
 - 5.1. Current Situation
 - 5.2. Policy Priorities
 - 5.3. Policy Initiatives
 - 5.3.1. Ensuring an Adequate Standard of Living for Disadvantaged and Vulnerable Groups and Encouraging their Integration / Reintegration into the Labour Market
 - 5.3.1.1. Horizontal Measures
 - 5.3.1.2. Public Assistance Recipients
 - 5.3.1.3. Persons with Disabilities
 - 5.3.1.4. Older Persons
 - 5.3.1.5. Children and Families at Risk of Poverty
 - 5.3.1.6. Drug Users
 - 5.3.1.7. Asylum Seekers
 - 5.3.1.8. Access to Housing
 - 5.3.2. Safeguarding Affordable Access to Government Services, including Education and Health to all

VI. ANNEXES

ANNEX 1: SUPPLEMENTARY INFORMATION

1. Guideline No. 11: To encourage the sustainable use of resources and strengthen the synergies between environmental protection and growth

- 1.1. Policy Priority 1: Energy efficiency and co-generation
 - 1.1.1. Environmentally friendly eco-efficient technologies
 - 1.1.1.1. Current Situation
 - 1.1.1.2. Policy Initiatives
- 1.2. Policy Priority: To promote the development of means of internalization of external environmental costs and decoupling of economic growth from environmental degradations
- 1.3. Policy Priority 3: Continue to fight against climate change, while implementing the Kyoto targets in a cost-effective way, particularly in regard to SMEs
 - 1.3.1. Current Situation
 - 1.3.2. Policy Initiatives
- 1.4. Policy Priority 4: Pursue the objective of halting the loss of biological diversity between now and 2010
 - 1.4.1. Current Situation
 - 1.4.2. Policy Initiatives
 - 1.4.2.1. Policy Framework
 - 1.4.2.2. Measures Underway / Planned

2. Guideline No. 12: To extend and deepen the Internal Market

- 2.1. Policy Priority Area 1: Speed up the transposition of Internal Market Directives
 - 2.1.1. Current Situation
 - 2.1.2. Policy Initiatives
- 2.2. Policy Priority Area 2: Give priority to stricter and better enforcement of Internal Market Legislation
 - 2.2.1. Current Situation
 - 2.2.2. Policy Initiatives
- 2.3. Policy Priority Area 3: Eliminate remaining obstacles to cross-border activity
 - 2.3.1. Current Situation
- 2.4. Policy Priority Area 4: Apply EU public procurement rules effectively
 - 2.4.1. Current Situation
 - 2.4.2. Policy Initiatives
- 2.5. Policy Priority Area 5: Promote a fully operational internal market of services, while preserving the European social model
 - 2.5.1. Current Situation
 - 2.5.2. Policy Initiatives
- 2.6. Policy Priority Area 6: Accelerate financial market integration by a consistent and coherent implementation and enforcement of the Financial Services Action Plan
 - 2.6.1. Current Situation

- 2.6.1.1. FSAP Policies
- 2.6.1.2. Other (supplementary) FSAP related Policies
- 2.6.2. Policy Initiatives
- 2.6.2.1. FSAP Measures
- 2.6.2.2. Supplementary FSAP related Measures

3. Guideline No. 15: To promote a more entrepreneurial culture and create a supportive environment for SMEs

- 3.1. Overall Situation
- 3.2. Policy Priority Area 1: Improve access to finance
- 3.2.1. Current Situation
- 3.2.2. Policy Initiatives
- 3.3. Policy Priority Area 2: Strengthening economic incentives including by simplifying tax systems and reducing non wage labour costs
- 3.3.1. Current Situation
- 3.4. Policy Priority Area 3: Strengthen the innovative potential of SMEs
- 3.4.1. Current Situation
- 3.5. Policy Priority Area 4: Provide relevant support services to SMEs
- 3.5.1. Current Situation
- 3.5.2. Policy Initiatives

4. Guideline No. 18: Promote a lifecycle approach to work

5. Guideline No. 19: Ensure inclusive labour markets, enhance work attractiveness, and make work pay for job-seekers, including disadvantaged people, and the inactive

- 5.1. Policy Priority 1: Active and preventive labour market measures
- 5.1.1. Current situation
- 5.2. Policy Priority 2: Continual review of the incentives and disincentives resulting from the tax and benefit systems
- 5.2.1. Current Situation
- 5.3. Policy Priority 3: Development of new sources of jobs in services to individuals and businesses, notably at local level

6. Guideline No. 20: Improve matching of labour market needs

- 6.1. Policy Priority: Removing obstacles to mobility for workers across Europe within the framework of the Treaties

7. Guideline No. 21: Promote flexibility combined with employment security and reduce labour market segmentation, having due regard to the role of the social partners

- 7.1. Policy Priority 1: Adaptation of employment legislation, reviewing where necessary the different contractual and working time arrangements
- 7.2. Policy Priority 2: Addressing the issue of undeclared work
- 7.2.1. Current Situation
- 7.2.2. Policy Initiatives

- 7.3. Policy Priority 3: Better anticipation and positive management of change
- 7.3.1 Current situation
- 7.4. Policy Priority 4: Promotion and dissemination of innovative and adaptable forms of work organization
- 7.5. Policy Priority 5: Support for transitions in occupational status

8. Guideline No. 22: Ensure employment-friendly labour cost developments and wage-setting mechanisms

- 8.1. Policy Priority 1: Encouraging social partners within their own areas of responsibility to set the right framework for wage bargaining
- 8.1.1. Current Situation
- 8.1.2. Policy Initiatives
- 8.2. Policy Priority 2: Reviewing the impact on employment of non-wage labour costs

9. Guideline No. 23: Expand and improve investment in human capital

- 9.1. Policy Priority: Significantly reducing the number of early school leavers
- 9.1.1. Current Situation
- 9.1.2. Policy initiatives

10. Guideline No. 24: Adapt education and training systems in response to new competence requirements

ANNEX 2: THE USE OF THE EU COHESION AND STRUCTURAL FUNDS IN SUPPORT OF THE LISBON OBJECTIVES

- 1. The Current Programming Period 2004 - 2006
- 1.1. Objective 2 Programme
- 1.2. Objective 3 Programme
- 1.3. Fisheries Programme
- 1.4. Cohesion Fund
- 1.5. Rural Development Plan
- 2. New Programming Period 2007-2013

ANNEX 3: TABLES ON POLICY INITIATIVES

- A. MACROECONOMIC CHALLENGES
- B. MICROECONOMIC CHALLENGES
- C. EMPLOYMENT CHALLENGES

I. INTRODUCTION

The Lisbon Council of March 2000 launched a strategy, with the objective of making the European Union (EU) the most competitive and dynamic knowledge-based economy in the world. With little progress achieved in the first years of the implementation of the Lisbon Strategy, the European Council invited the Commission in March 2004 to establish a high-level group, headed by the former Prime Minister of the Netherlands Mr. Wim Kok, with the purpose of carrying out an independent review of the Lisbon Strategy. The review, which was presented to the European Commission on November 3, 2004, recommended that the Lisbon strategy refocuses on growth and employment, bearing in mind the need to maintain social cohesion and to ensure environmental sustainability. Building on the findings and suggestions of the Kok Report, and following extensive discussions at the EU and national levels, an Integrated Package of Guidelines was developed and agreed upon, as a basis for the preparation of the National Lisbon Programmes. To enhance the effectiveness of these programmes and increase the sense of ownership of the Lisbon strategy, the European Council called upon member states and the Commission to engage and mobilize all relevant parties and stakeholders at the national and Community levels in the preparation and implementation process.

Cyprus, fully, supports these efforts and welcomes the decision to prepare National Lisbon Programmes, in order to achieve the targets set out in the Lisbon strategy. The initiative undertaken by the European Commission to visit all member states, and discuss with the national authorities and the social partners the preparations of the National Lisbon Programmes, was of particular significance. The consultations, which took place in Cyprus on the 25th of July 2005, were indeed constructive and helpful for the preparation of the National Lisbon Programme.

During the preparation of the National Lisbon Programme of Cyprus, social partners, political parties and the private sector in general were informed and consulted extensively. Thus, the preparation of the report provided a much-needed platform for a constructive dialogue with all stakeholders on the broad reform agenda. The draft Lisbon programme was prepared by mid-September 2005 and discussed with social partners and the political parties and the final version was submitted to and approved by the Council of Ministers. We consider that the strong involvement of all interested parties in the process of preparing the programme has contributed positively in enhancing the sense of national ownership of the Programme.

The National Lisbon Programme will be available on the website of the Ministry of Finance. Upon publication, all stakeholders will be invited to submit suggestions regarding the establishment of an effective monitoring mechanism for the implementation of the Programme. Implementation of the measures and policies included in this report will require a continuous dialogue with all stakeholders and a monitoring mechanism will be established under the coordination of the Ministry of Finance. Progress reports will be prepared on a regular, bi-annual, basis and will be submitted to the Council of Ministers. Gradually, a set of indicators will be developed to facilitate the assessment of progress in the implementation of the Lisbon Programme. As a starting point, the core structural indicators could be used towards this end.

The main paper will concentrate on tackling the main challenges identified for Cyprus. It is structured in three chapters: macro, micro and employment. Annex 1, provides a broad discussion of guidelines

not covered elsewhere in the main text. Annex 2 presents information concerning the use of the Cohesion and Structural Funds in support of the Lisbon objectives. Annex 3 comprises of a set of tables with the specific measures and policy actions included in the Programme, the implementing authority responsible for each measure, the timetable set for implementation of these policies, as well as, where this is available, their budgetary impact. This set of tables transforms the National Lisbon Programme into an operational programme and facilitates the monitoring for its implementation.

Key Challenges for Cyprus

1. Sustainability of public finances;
2. Improve the quality of public finances via a redirection of public expenditure;
3. Increase the diversification of the economy towards higher value added activities via, mainly, an increased utilisation of the comparative advantages of the island;
4. Promotion of R&D and innovation and facilitation of ICT diffusion;
5. Structural reforms targeting at enhancing competition and improving the overall business climate;
6. Upgrading of basic infrastructures;
7. Further human capital development;
 - Enhancement of the links of the educational system to labour market needs
 - Development of a comprehensive national framework for lifelong learning
 - Continuous upgrading and adaptability of skills to labour market needs
8. Further enhancement of the conditions of social cohesion;
9. Ensuring environmental sustainability.

II. OVERALL STRATEGIC APPROACH AND KEY CHALLENGES

Overall Strategic Approach

The overall strategic approach focuses on the need to tackle effectively the challenges faced by Cyprus. The overriding objective of the National Lisbon Programme of Cyprus is to enhance the growth potential of the economy and raise the standards of living and hence achieve real convergence with the EU. The proposed reforms pay particular attention to the need to enhance social cohesion and achieve a more efficient use of natural resources so as to ensure the sustainability of growth over the longer term.

The proposed national Lisbon Strategy aims at creating a dynamic and competitive economy which will deliver high growth and living standards for the citizens of Cyprus. A healthy and stable macroeconomic environment underpinned by sound fiscal and monetary policies, is a prerequisite for the successful implementation of these reforms. Policies to enhance investment in physical and human capital, research and development, and the country's infrastructures are key.

The enhancement of productivity and of the competitiveness of the economy constitute core elements of the Programme which will help raise long-term growth, but will also make the transition and participation to the eurozone easier.

Sound macroeconomic policies, structural reforms in labour, product and capital markets by member states are also imperative for a more dynamic and well-functioning European Monetary Union (EMU). Policy coordination is key in this respect and the policies set out in this document are based on the principles governing EMU and the long-run targets outlined in the Lisbon Agenda (Guideline 6).

Sustainability of Public Finances

To achieve the long-term objectives set out in the Lisbon Agenda the current programme focuses on the need to safeguard economic and fiscal sustainability, as a basis for increased employment, and to promote a growth- and employment-oriented and efficient allocation of resources (Guidelines 1, 2, and 3). Fiscal consolidation is key in freeing resources for the implementation of the programme. A sound fiscal policy is important in itself for maintaining macroeconomic stability and boosting growth in the long run.

Within this broader context, a key challenge for policymakers is to secure longer-term sustainability of public finances in light of population ageing (Guideline No. 2). The process of population ageing is crucial both for its impact on the public finances and on long-term growth. Based on the projections presented in the last Convergence Programme, under the assumption that no reforms are undertaken, spending on pensions will increase significantly while social security contributions will fall. Consequently, the budget deficit is set to widen considerably by 2050. This prospect requires more ambitious fiscal targets, with specific plans to control expenditure and enhance the efficiency of the tax system, measures to increase labour market participation and employment especially among the female and old aged, and a restructuring of the social insurance and health care systems.

Fiscal consolidation based on structural measures is contributing to a virtuous circle for macroeconomic stability and economic growth, with lower government borrowing requirements and fiscal credibility leading to reduced borrowing costs and greater business confidence. Thus, in line with the challenges set out in the Lisbon Strategy, the overriding objective is to continue with the fiscal consolidation programme and to build upon the progress achieved in 2004 and 2005 in reducing the government deficit and in placing the government debt to GDP ratio on a downward path. The medium-term targets set by the Convergence Programme and the Stability and Growth Pact (SGP), and the aspiration to adopt the euro by January 1, 2008, require the government to nearly balance its budget by 2009, and thereafter to keep its budget balanced “in the medium term”. Policies must remain focused on achieving these objectives, while at the same time safeguarding macroeconomic stability and external sustainability.

Improve the Quality of Public Finances

Achievement of these goals requires an improvement in the quality of the public finances and public expenditure management systems, but also a tax system which is supportive of the supply side of the economy (Guideline No. 3). The promotion of a growth- and employment-oriented and efficient allocation of resources is key in this respect; hence, policies outlined in this document aim at increasing the share of government expenditure in growth-enhancing categories, such as education, research and development, physical infrastructure as well as to other policy priorities pursued within the framework of the National Lisbon Programme. The formulation and implementation of budgetary policies in a medium-term framework would allow better implementation of policies, incorporated in the Convergence and National Lisbon Programmes of Cyprus.

Increase the diversification of the economy

More investment should aim at further diversifying the economy which is dominated by services and in particular by tourism.¹ This partial dependence on tourism in particular, renders the economy vulnerable to exogenous economic and geopolitical shocks. Further diversification of the economy and strengthening of the entrepreneurial culture, will enhance its production base and make the economy more resilient and competitive (Guideline No. 10).

Promote R&D and innovation and facilitation of ICT diffusion

In order to support long-term growth, a key priority of the Government is to boost investment in physical and human capital. This requires higher capital spending, as well as more expenditure on education and Research and Development (R&D). It is widely accepted that R&D and innovation, and the wider utilisation of information technology are key in attracting foreign direct investment, boosting productivity and growth (Guidelines 7, 8, 9).

¹ The overall contribution of the tourist industry, taking into account the value added created from the direct purchases of goods and services by tourists and the inter-sectoral linkages between the sectors of economic activity, fluctuated between 15% and 20% in the 1990-2002 period; it has fallen below 15% over the past two years.

Structural reforms targeting at enhancing competition and improving the overall business climate

The Authorities, conscious of the strong linkages between macroeconomic, structural and employment policies, will seek to promote greater coordination and coherence across ministries and policy objectives, so as to achieve more efficiently the ambitious long-term goals (Guideline 5). Accordingly, further reforms in labour and product markets are not only directed toward raising the growth potential of the economy, but also at increasing the adaptability and flexibility of the economy to adjust to globalization, technological advances, demand shifts and cyclical changes. Demand management policies aim at attaining the full employment of productive resources, while structural and employment policies are directed at further enhancing the functioning of the market mechanism, improving incentives and raising employability, through upgrading of the quality of human capital. In addition, structural reforms are needed to increase the flexibility of the economy and support external competitiveness. These reforms should further aim at enhancing competition and improving the overall business climate (Guidelines No. 13 and 14).

The role of the Government is critical because of its contribution to the development of institutions and labour market regulations, and because of its influence as a relatively large employer. Reforms to increase flexibility in the labour market are imperative (Guidelines No. 21 and 22). In addition, reform of the public sector as well as a wage bargaining system, which, while fully respecting the role of the social partners, leads to wage and cost developments that are consistent with price stability and trends in productivity are also essential (Guideline 4).

Upgrading of basic infrastructures

Upgrading of the physical infrastructure network - which, considering the country's relatively high standard of living, remains deficient in some areas - is central in this ambitious attempt and should proceed swiftly but in accordance with environmental concerns and best practises (Guideline 16).

Further human capital development

Enhancing of physical and human capital is key in raising productivity and boosting the economy's potential growth. Development of human capital is especially important in an economy dominated by the services sectors. Rapid changes in the communication and information technology sectors and structures of production as well as the organisation of work and the labour market require constant upgrading of the educational and training systems, as well as more emphasis on lifelong learning (Guidelines No. 23 and 24).

Further enhancement of the conditions of social cohesion

Successful implementation of the reforms and achievement of the targets set out in the Lisbon agenda requires social cohesion and economic equality. Social policies which aim at raising the standards of living for vulnerable groups, by encouraging their integration/reintegration into the labour market, as well as by providing affordable access to education and healthcare are considered important.

Ensuring environmental sustainability

The reform agenda will be pursued vigorously taking into account environmental concerns and the “true” costs of policies both for current and future generations. Ensuring environmental sustainability is a key element of the proposed Lisbon Programme (Guideline No. 11).

III. MACROECONOMIC CHALLENGES

A. Macroeconomic Situation

The economy of Cyprus has performed relatively well during the last few years in spite of the challenging external environment. Average growth of 3.9% during the period 1994-2003 was supported by a relatively stable private consumption growth, and a small, though non-negligible, contribution from investment and public consumption. However, the susceptibility of the economy to external shocks has been evident in the volatility of exports, which in large part are due to the impact from tourism, and the current account balance. After a slowdown in 2002-03 growth has accelerated and is forecast to reach 4.1% in 2005.

Table 1. Key Macroeconomic Indicators

% annual change	1994-2003	2004	2005
GDP	3.9	3.8	4.1
CPI ²	3.1	1.9	2.2
Unemployment Rate ³	n.a.	4.7	5.5 ⁴
Unemployment Rate ⁵	3.2	3.6	3.8
Employment	1.8	1.9	1.9
Nominal Earnings	5.9	3.6	4.8
Productivity growth	2.1	1.9	2.1
Current Account ⁶	2.6 ⁷	5.6	5.5

Inflation has remained subdued—averaging some 3 percent over 1994-2003—despite large increases in oil prices and large swings in exchange rates, and it is expected to reach 2.2% in 2005. Annual increases in nominal wages averaged 5.9% over the 1994-2003 period, reflecting productivity improvements and tight labour market conditions in some sectors. A rising number of foreign and Turkish-Cypriot workers is expected to exert a moderating effect on wages in the coming years, as was the case in 2004 when nominal earnings rose by less than 4%.

With the unemployment rate, based on the labour force survey, at 5-5.5% of the labour force, labour market conditions remained tight. Labour shortages (e.g. in the sectors of hotels and restaurants, trade and construction and at the occupational level in technical and low skilled occupations), have been addressed, to a large extent, by an increased supply of foreign workers and Turkish Cypriots. The tight labour market conditions are unlikely to be reversed as the old-age dependency ratio is projected to

² National Consumer Price Index for the period 1999-2003; harmonised for 2004 and 2005.

³ Based on the labour force survey, percent of labour force

⁴ First-Quarter 2005

⁵ Registered Unemployment percent of labour force.

⁶ Percent of GDP

⁷ Average for 1994-2003

increase from 17.5% in 2004 to 43.2% in 2050, with both a declining fertility rate and a rising life expectancy contributing to this trend.

The strong economic performance can be accredited to sound economic policies. A credible monetary policy, underpinned by a fixed exchange rate arrangement, provided macroeconomic stability and helped to pin down inflation expectations. Following the worsening of the government finances in 2002 and 2003, a revamped programme of fiscal consolidation has been central to the successful efforts of the Government to bring about economic stabilization. Indeed, fiscal consolidation has been the cornerstone of the last Convergence Programme and its effective implementation contributed importantly to the positive decision for participation of Cyprus in ERM II as from April 29, 2005. The general government deficit was reduced from 6.3% of GDP in 2003 to 4.1% of GDP in 2004 with a further improvement expected in 2005, which will bring the deficit to levels below 3% of GDP (Table 2).

Table 2: Selected Fiscal and Government Debt Indicators⁸

in percent of GDP	2003	2004	2005	2006	2007	2008
Government revenue	39.1	39.5	41.2	40.0	40.0	39.6
Government current expenditure	41.4	39.5	39.7	37.9	37.8	36.8
Interest payments	3.5	3.2	3.2	3.1	3.0	2.6
Government capital expenditure	4.0	4.1	4.0	4.0	4.0	4.0
Overall budget balance	-6.3	-4.1	-2.5	-1.9	-1.8	-1.2
Primary balance	-2.8	-0.9	0.7	1.2	1.2	1.4
Government debt	69.4	71.3	70.5	67.0	64.0	56.9

While the fiscal deficit has been reduced significantly, the current account deficit, has remained around 5.5% of GDP. Transitory as well as more structural reasons are behind the moderately high current account deficit. Accelerating oil prices have pushed imports of oil-related products significantly higher although this trend is expected to be reversed in the medium term. Conversely, higher investment and imports of capital goods have raised the underlying current account deficit. While the transitory factors will dissipate in the medium term, the process of real convergence will tend to maintain the current account deficit at somewhat moderate levels, which can however be financed by non-debt creating flows, in particular if there is success in the efforts to boost productivity and enhance competitiveness.

⁸ Figures in latest Convergence Programme have been updated to reflect latest developments and revised projections.

B. Macroeconomic Challenges

1. Securing Stability for Sustained Growth through Fiscal Consolidation (Guidelines 1 and 3)

1.1. Policy Priorities

In order to provide firm ground for achieving the ambitious targets of the Lisbon Agenda, the Authorities intend to enhance their fiscal consolidation efforts by making progress in four directions:

- Implementation of the measures incorporated fiscal consolidation programme to achieve the fiscal targets set;
- Changes in the composition of public expenditure;
- Tax efficiency gains through increase in compliance and better administration;
- Enhancing fiscal management and governance.

The SGP requires countries, over the medium-term to achieve their country specific medium term objective and to accomplish faster fiscal consolidation in “good times”. To comply with this requirement the structural deficit must be reduced further over the medium term towards a position of “close to balance”.

Based on current projections, and in line with the Government commitments included in the Convergence Programme, the general government deficit is expected to decline from 4.1% of GDP in 2004 to 1.2% by 2008, and the ratio of public debt to GDP is projected to fall from 71.3% in 2004 to 70.5% in 2005 and further to 56.9% by the end of 2008 (Table 2).⁹ This adjustment path entails a series of measures aimed at curtailing public expenditure and boosting public revenues.

Preserving the main features of the current tax system, which is based on a broad tax reform implemented since 2002, and restructuring of the expenditure system in order to achieve a more efficient allocation of resources and enhance the supply side of the economy is a key task for the Authorities. More emphasis on improving the quality of public finances - attaching particular importance on growth-enhancing spending categories in line with the Lisbon Strategy - is considered essential for the achievement of these goals.

Better management of public finances is also important. Improved expenditure planning and control - particularly within a medium-term framework - can realize considerable savings and enable budgetary resources to be better directed towards growth-enhancing expenditures.

1.2. Policy Initiatives

1.2.1. Fiscal Adjustment and Debt Reduction

The Convergence Programme which aims at reducing the general government deficit to 1.2% of GDP by 2008 entails a series of measures to curtail expenditure and boost revenues. A number of measures have already been introduced to keep expenditure growth in check including the following:

⁹ This reflects also the phasing out of the system of sinking funds used for debt redemption.

- A restrictive policy towards the recruitment of new personnel;
- A restrictive wage policy for the broad public sector;
- Imposition of ceilings on growth of current expenditures and capital expenditures;
- Freezing of grants to semi-governmental organizations, reduction of agricultural subsidies, significant cuts by 30% in overtime allowances;
- Cuts in defence spending by some 1 percentage point of GDP in 2004;
- Extension of the retirement age for public sector employees from 60 to 63 years of age, effective as from July 1, 2005;
- Introduction of a more efficient system for the issuance of real estate deeds.

Table 3: Components of Fiscal Adjustment

<i>in percent points of GDP</i>	2004	2005	2006	2007	2008	2009	Total Adjustment¹⁰ 2006-2009
Expenditure containment	1,3	-0,2	1,9	0,1	1,0	1,1	4,1
<i>Once-off expenditure measures</i>	-	-	-	-	-	-	-
Revenue enhancing measures	1,0	1,7	-1,3	-0,1	-0,6	-0,7	-2,7
<i>Once-off revenue measures</i>	1,0	0,9	-	-	-	-	-
Cyclical component	-0,1	0,0	0,1	0,1	0,2	0,2	0,6
General Government Net Borrowing	-4,1	-2,5	-1,9	-1,8	-1,2	-0,6	1,9

To strengthen further the underlying fiscal position a series of measures are currently being considered which will improve the deficit in structural terms¹¹:

- Upward adjustment of land registry and survey fees;
- Evaluation of real estate at current market prices, for the calculation of property taxes;
- Measures to improve tax collection;
- Participation in the profits of public sector corporations;
- Revision of the eligibility criteria for social benefits so that more benefits are provided to those in greater need.

¹⁰ The figures may not add up to the total due to rounding effects

¹¹ The central governments' budget for 2006 was approved by the Council of Ministers on August 25, 2005 and has been submitted to the House of Representatives for approval.

With primary surpluses from 2005 onwards, and better public debt management, the public debt will be reduced significantly in the medium term to 56.9% of GDP.

1.2.2. Composition of Government Expenditure

To achieve the targets of the Lisbon Strategy and keep the fiscal consolidation programme on track the Government will:

- Maintain the already high share of capital expenditure to GDP;
- Control current expenditure in nominal terms;
- Limit significantly subsidies.

Considerable progress has been achieved at improving the quality of government expenditure. Sizable cuts in defence spending, agricultural subsidies and grants to semi-governmental organizations have been accomplished. Stricter controls on current expenditures have freed resources for spending on education and investment. Towards this end, development outlays and spending on education have increased by some 1-1.25% GDP since 2002, while R&D spending also increased significantly.¹² Government expenditure on information technology also increased significantly to some 0.3% of GDP in 2004.

In view of the considerable importance the Government attaches to raising the level of resources channelled to growth-enhancing expenditure categories such as infrastructure, R&D, computerization, e-government, education and health, it is planned that government expenditures on such activities be raised by some of 6% per annum over the medium-term.¹³ Such an important increase in expenditure as well as the expenditure required for the other measures / actions included in the Lisbon Programme, will be financed by national and EU resources, as well as through public-private partnerships. It is noted in this respect, that for the overwhelming majority of the measures and actions, included in the Lisbon Programme, planned for 2005 and 2006 there are relevant budgetary provisions in the Budget Law for 2005 and in the submitted Budget for 2006.

1.2.3. Tax Policy

Restructuring of the tax system in order to achieve a more efficient allocation of resources and enhance the supply side of the economy is a key policy priority for the Authorities. To this end, a major reform took place between 2002-04 which aimed at harmonizing the tax system with the EU's code of conduct on business taxation, simplifying the income tax law, and adjusting VAT and excise rates in line with EU minimum levels. While shifting the tax burden from direct to indirect taxation, the tax reform lowered significantly the tax burden on capital and labour.¹⁴

¹² Development expenditures comprise mainly expenditure on the upgrading and construction of physical infrastructure including roads, water utilities and rural facilities as well as purchases of capital equipment and ancillaries by the education and health sectors.

¹³ Several initiatives have been launched which aim at promoting e-Government and the provision of on-line services to the public in line with the EU strategic framework on the "European Information Society 2010". Other initiatives include the creation of a technology park, the establishment of a research and training centre in co-operation with Harvard University and the setting up of the Cyprus Research and Educational Foundation.

¹⁴ The tax reform which entered its last phase as from January 2004 provided for a much lower taxation of labour income, that entailed a considerable increase in the limit of non-taxable income and an upward revision of the income categories

Despite the fact that the tax system is fairly simple and the tax burden relatively low, improving tax collection remains a key challenge for policymakers. Following the tax reform, policies have focused on the need to raise tax collection and enhance tax compliance. A tax amnesty has yielded considerable revenues, and is expected to help tax compliance and boost tax collection in the future.

Tax administration services are being strengthened with a series of measures designed to facilitate the collection of taxes and discourage tax evasion. The following measures have been introduced as of January 2005:

- Partial lifting of bank secrecy has commenced and is expected to improve the tax authorities' ability to obtain information on individual cases;
- New legal provisions enable the tax authorities to persecute the management of corporations in cases of delays in tax payment;
- Stiffer fines for past-due tax returns and payment of taxes have been introduced.

Further revisions to the existing legislation are included in a draft bill which will be adopted soon by the House of Representatives:

- Introduction of a self-assessment system for self-employed individuals. This would require payment of taxes concurrently with submission of tax return;
- Compulsory submission of tax returns for all persons earning more than the tax-free threshold;
- Compulsory maintaining of accounting records by companies, and self-employed individuals earning income above a certain threshold;
- A further increase of penalties for late submission of tax returns.

1.2.4. Fiscal Management, Transparency and Good Governance

In early 2005 the IMF was invited to undertake a report on the Observance of Standard and Codes (ROSC) for Cyprus and assess compliance with the IMF's "Code on Good Practices on Fiscal Transparency". The report concluded that "Cyprus has been making major progress in improving fiscal transparency, helped by the Government's efforts to strengthen budget management system and comply with the *acquis communautaire*. As a result, the country now fully meets or even exceeds the Code's standards in many areas".

The IMF fiscal ROSC pointed out, however, that more progress was warranted in the areas of the public expenditure and financial management. To bring the management of public finances in line with best practices a number of initiatives have been taken, including the introduction of a comprehensive financial information and management system (FIMAS) from January 2004.

Furthermore, the following measures are planned to be promoted:

- The Ministry intends to initiate the preparation of a medium-term budgetary framework (MTBF) which will take into consideration the medium-term targets and policies incorporated in the Convergence and the National Lisbon Programmes of Cyprus. Such a medium-term budgetary framework will improve the ability of the Government to prioritize programmes

taxed with the marginal rates of 20%, 25% and 30%. Furthermore, the defence levy of 2% on emoluments of physical persons was abolished as from June 1, 2002, while the professional tax on income of physical persons was abolished on January 1 2003. While unemployment benefits aim at providing adequate financial support, they are of limited duration (156 working days) and in conjunction with the relatively low taxation of labour incomes provide incentives to work and make work pay.

based on the needs of the economy, tighten further public expenditure limits and minimize the scope for amending the budget. The Authorities intend to introduce the MTBF with the preparation of the Budget for 2007. To prepare for this ambitious and important task, the Government has already requested technical assistance from the IMF and it is expected that a team will visit Cyprus in early 2006 to this end.

- Further “fiscal structural reforms” will lay down the key principles for the formulation of fiscal policy, integrate a multi-year budgetary process, and set strict procedures on spending both for broad spending categories as well as for Ministries.
- The new policy framework will limit significantly the practice of submitting supplementary budgets and will boost significantly the credibility of fiscal policy.

2. Safeguarding Economic and Fiscal Sustainability as a Basis for Increased Employment and Promoting Greater Coherence Between Macroeconomic, Structural and Employment Policies (Guidelines 2 and 5)

2.1. Policy Priorities

Ensuring the sustainability of public finances over the long term requires, inter alia, significant improvement in the underlying fiscal position to prepare the economy to withstand the upcoming demographic changes. To achieve a structural improvement in the public finances, policies will focus on strategies to increase labour participation and boost the supply of labour and reform the social insurance and healthcare systems.

2.2. Policy Initiatives

2.2.1. Increasing Labour Market Participation and Expanding the Labour Supply

Employment policies are not only directed at achieving full employment, but together with other social policies, aim at assisting workers adjust to shifts in labour demand arising from structural changes, technological advances, demand shifts and cyclical changes. A number of measures are proposed to increase labour market participation and labour supply among vulnerable groups. These measures are:

- To deal with the problem of youth unemployment and to enhance female employment participation, Cyprus will implement specific schemes promoting the training and employability of young secondary education graduates and economically inactive women.
- Various other initiatives will be undertaken which target female workers, in particular, including expansion of childcare facilities, and the promotion of flexible forms of employment.
- Given the tight labour market conditions, a continuous inflow of foreign workers, will continue to boost labour supply especially in sectors with severe skill shortages. The employment of Turkish Cypriots will also be actively encouraged.

2.2.2. Reform of Social Insurance and Health Care Systems

Reforming the social security and health care systems is crucial for securing long-term fiscal sustainability. A National Strategic Report¹⁵ on adequate and sustainable pensions has already been prepared and a number of measures are planned, or are being assessed, with a view to strengthening significantly the financial viability of the social security system.

Social Security System

Reforming the social security system is a challenging task which requires a cautious approach, wide ranging dialogue and political consensus. The Government intends to intensify the dialogue in the context of the implementation of the Lisbon agenda. In this dialogue the following proposals will be considered:

- (i.) Increase of the social security contribution rates of the employers by 1 percentage point (from 16.6% to 17.6% of earnings);
- (ii.) Following the recent increase of the retirement age of civil servants to 63 years, similar changes are planned for the semi-governmental organizations and for teachers. The scope for a further gradual increase of the pensionable age within the framework of the Social Insurance Scheme to 65 years during 2007-2011 will be discussed with the social partners;¹⁶
- (iii.) To improve further the financial outlook for social security, the Authorities intend to discuss with the social partners the scope for tightening the eligibility criteria for old-age pension. Finally, the Government will put on the table, the proposal to index pensions to the consumer price index, instead of earnings. However, the implementation of such a measure will be accompanied by measures, which would ensure that such an important change does not affect the adequacy of pensions, in particular for the disadvantaged groups.

Health Reform

Progress has been slow on the reform of the health care system.¹⁷ Improvements have to be made both in the provision of health care, and the management of hospitals and resources, especially medical supplies. Draft legislation for the transformation of public hospitals to more autonomous units is currently being prepared, along with plans to introduce a National Health Insurance System (NHIS). Other administrative changes are underway, which will increase the effectiveness of the current system and minimize its impact on the public finances.

¹⁵ National Strategy Report on Adequate and Sustainable Pensions, Republic of Cyprus, July 2005, http://europa.eu.int/comm/employment_social/social_protection/docs/2005/cy_en.pdf.

¹⁶ The retirement age for civil servants was raised from 60 to 63 years as from July 2005.

¹⁷ The health care system is confronted with number of problems including unfavourable conditions for competition which favour the public sector against the private sector in the provision of health services; parallel-uncoordinated public and private sector providers lead to duplication and resultant waste; excess of total supply of hospital and high technology equipment; antiquated organization and management of public hospitals which lead to low levels of productivity; and low fees for use of public hospital services which result in unnecessary use of services and tests. Health care expenditure is projected to increase considerably faster than GDP as a result of rising operational costs, higher demand for services and an ageing population (see W.C. Hsiao, NHIS and its Cost, Nicosia, 2003).

Reform of the health care system will proceed in two steps:

- Hospitals will be organised into autonomous establishments under the wider public sector. They will have financial independence and will compete with other private sector hospitals for the provision of healthcare. As such, these units like other private hospitals will be required to apply cost minimisation principles and will therefore strive to provide the best possible care at a cost which reflects costs and market prices.
- In the second phase, planned for 2008, the NHIS will be launched. This will establish universal, healthcare coverage within the public healthcare system. It will also bring to the forefront the role of the general practitioner doctor so as to control more effectively referrals to specialists both domestically and overseas. These changes will improve considerably the efficiency of the hospital system and although the start-up costs will be significant, it is estimated that the medium- to long-term benefits will be large both for the provision of healthcare itself, and the long-run economic repercussions.

3. Ensuring that Wage Developments Contribute to Macroeconomic Stability and Growth (Guideline 4)

With fiscal policy constrained by the large fiscal deficit, and the exchange rate fixed inside ERM II, flexibility of prices and wages is critical. Wage developments spill over to prices which in turn influence competitiveness. Hence, workers, employers and the Government have a responsibility to ensure that prices and wages are set in a way that is consistent with underlying fundamentals and do not therefore impinge negatively on competitiveness. The policies set out in the Lisbon Programme will, if successful, raise productivity and keep prices in check provided that wage demands remain in line with underlying labour productivity developments.

Following a period when nominal wage increases exceeded labour productivity gains and the government finances were deteriorating, the Authorities imposed a freeze on contractual wage and salary increases in 2004 and 2005 for government employees.¹⁸ Wage moderation also in the private sector contributed to a generalised wage restraint and led to real wage increases of around 1.5% in 2004, in line with labour productivity gains. Participation of foreign labour, which reached 14% of the labour force in 2004, and of Turkish-Cypriot workers¹⁹, also restrained wage increases.

The role of the Government is critical both for its contribution to the development of institutions and labour market regulations, but also because of its influence as a large employer. Reforms to increase flexibility in the labour market are necessary. Consequently, the following actions are planned:

¹⁸ Wages for most employees are negotiated on a voluntary basis under collective agreements governed by the Industrial Relations Code. Wages and salaries consist of three main components: (i) contractual basic wage and salary increases negotiated in collective agreements usually for two to three years and geared to recent labour productivity gains, (ii) cost of living allowance indexed to average CPI inflation (excluding excise tax increases) in the preceding six months twice a year; and (iii) for public sector and bank employees, salary increments, reflecting years of service, promotions and upgrading. Thus, wage and salary increases are, to a large extent, determined by past inflation and labour productivity developments.

¹⁹ Turkish-Cypriot workers constituted around 1 percent of the labour force.

- Moderate contractual salary increases in the public sector for 2006-07, following zero contractual salary increases in 2004 and 2005; wages will rise by 2% and 1% in 2006 and 2007 respectively;
- The Government will work with the social partners to ensure wage moderation across the economy, endeavouring to keep contractual wage increases in line with underlying productivity gains;
- The Government will continue to encourage the employment of Turkish Cypriots;
- The Government will proceed with reforms in the labour market, as presented in the employment chapter.

IV. MICROECONOMIC CHALLENGES

1. Promotion of the further Diversification of the Economy towards the Production of High Value Added Goods and Services – Strengthening the Competitive Advantages of its Production Base²⁰

1.1. Current Situation

A basic characteristic of the Cyprus economy is the upward trend in the contribution of the tertiary sectors of services at the expense of both the primary sectors and the secondary sectors. This development reflects the comparative advantages of Cyprus, which stem mainly from:

- its strategic geographical location, at the crossroads of three continents,
- the generally favourable business climate,
- the high level of human capital endowment (high educational level of the labour force, in conjunction with the lower, by international comparison, level of tertiary educational level graduates' remuneration);
- the well functioning banking sector and high quality business services;
- the relatively advanced level of infrastructure, particularly in the sectors of telecommunications and transport, despite certain deficiencies.

The hotels and restaurants sector's share to GDP rose throughout the 1980s (3.6% in 1980, 10.6% in 1990). During the 1990s and over the first four years of the new century, however, the sector exhibited fluctuations, and its share was contained to 7.6% of GDP in 2004, confirming its vulnerability to exogenous and imponderable factors. As already mentioned, there is a certain dependency on the broader sector of tourism, whose medium- and long-term prospects will depend, to a decisive extent, on the further success of the efforts for upgrading and enriching the tourist product, as well as the ability of Cyprus to offer a unique tourist product, i.e. a multidimensional tourist experience in a small geographical area.

The remaining tertiary sectors of services, exhibit a strong dynamism, reflected in high rates of growth, an increase in their share to GDP and an expansion of their shares in international markets, a development attributed to the comparative advantages that Cyprus possesses in these sectors and which can be further utilised during the coming years. In relation to this, the accession of Cyprus to the EU and particularly the safeguarding of the right of establishment and the freedom to provide services, creates additional opportunities through the unhindered access of Cypriot services to the large internal market of the EU. Moreover, improved security conditions, via the accession of Cyprus into the EU, in conjunction with the comparative advantages of Cyprus, are expected to improve the attractiveness of the island as a business centre for the provision of services in the region.

The prospects in the sectors of business services, private tertiary education and health, financial services, shipping, trade and telecommunications seem particularly favourable, especially if production focuses on high quality services.

²⁰ It corresponds broadly to Guideline No 10 of the Integrated Guidelines.

In contrast to the increasing share of the services sectors, the agricultural sector's share to GDP has been declining (10% in 1980, 7.1% in 1990 and 3.3% in 2004), a development that reflects, to a great extent, the stage of economic development attained by the Cyprus economy. Particular restraining factors to the growth of the agricultural sector constituted the Turkish invasion and occupation of a significant percentage of its fertile land, the chronic scarcity of water for irrigation, as well as the small size of the agricultural units, hindering the utilization of modern methods of production and the exploitation of economies of scale.

Another sector that exhibits a fall in its share to GDP since the early 1980s is that of manufacturing (18.2% in 1980, 14.7% in 1990, 9.4% in 2004), which is marked by severe problems of competitiveness, with the concentration of production on low value added activities, where quality, design, innovation and the level of specialisation is low. A positive development in the sector constitutes the dynamism exhibited by certain sub-sectors such as pharmaceuticals, but also by manufacturing units in traditional sub-sectors, giving emphasis to the production of advanced technology and knowledge intensive products.

Moreover, despite Cyprus' small size and the high rate of economic growth observed over the past decades, regional disparities do exist. Rural areas have undergone demographic weakening, while population and business activities have concentrated in the major urban centres and the coastal areas which have experienced rapid tourist development. Furthermore, the inner parts of urban areas are in decline, especially in the capital city of Nicosia, which is divided by the cease-fire line.

1.2. Policy Priorities

To exploit better the comparative advantages of Cyprus and enhance its competitiveness, the Programme focuses on four broad policy priority areas:

- Further promotion of the restructuring and the diversification of the economy towards the production of high value added goods and services;
- Upgrading and enriching the tourist product;
- Enhancement of the competitiveness of the manufacturing sector;
- Enhancement of the production base of disadvantaged areas.

1.3. Policy Initiatives

1.3.1. Further Promotion of the Restructuring and the Diversification of the Economy²¹ towards the Production of High Value Added Goods and Services²²

²¹ The diversification of the economy is expected to be further enhanced in the coming years not simply through the measures included in this section, but broadly through, generally, all policy initiatives under the microeconomic and employment chapters.

²² This section covers the broader range of economic activities.

Measures taken

- Abolition of all restrictions on foreign direct and portfolio investment by residents of third countries, except in few cases provided differently in sector specific legislation, as from 1.10.2004.
- The modernization of the tax system, implemented since 2002, which provides for relatively low tax rates on both corporations and individuals and favours investment and restructuring of enterprises.
- Implementation of a scheme providing assistance to exporters of services, for the conduct of market research in foreign markets, aiming at identifying the prospects for exporting services in new markets.

Measures underway / planned

- Expansion of the network of double tax treaties, with a view to facilitating foreign investment in Cyprus
- The upgrading of the operations of the “one stop shop” at the Ministry of Commerce, Industry and Tourism, with a view to simplifying procedures, reducing administrative cost and providing guidance and assistance to local and foreign investors.
- Setting up of an agency for the promotion of Cyprus as an entrepreneurial base and the attraction of foreign direct investment, aiming at accelerating the transition of the Cyprus economy into a knowledge-based economy. It is expected to be set up in 2006.
- Establishment of private universities. A recently approved legislative framework by the House of Representatives (July 2005), is expected to pave the way for the operation of private universities in Cyprus.

1.3.2. Upgrading and Enriching the Tourist Product

Measures underway / planned

With a view to promoting the sustainable development of tourism, the new Strategic Development Plan for Tourism (2003-2010) was approved by the Council of Ministers in November 2003. The main objectives are to enrich the tourist product and address the problem of seasonality. It focuses on marketing, product development and quality/value added, with comprehensive action plans in each area.

Indicatively, the most important measures included in the Plan are the following:

- Marinas: A number of marinas are planned to be constructed with the BOT method, with a view to address the problem of seasonality and attract tourists throughout the year, as well as to attract higher spending tourists.
- Golf: Incentives in the form of spatial planning provisions and development rights will be provided for the development of a maximum of 14 golf courses in all regions and tourist resorts to potential investors.

- Sports tourism – An action plan for the development of sports infrastructure / marketing is planned to be implemented.
- Casino – Two studies are currently been undertaken to evaluate the social and economic impact of the creation of casinos in Cyprus. They are expected to be completed by the end of the year.
- Measures aiming at the development and marketing of rural tourism and offering alternative sources of revenue to the rural population. The measures are co-financed from the European Regional Development Fund under Objective 2 of the Structural Funds and include the following:

Development of a Cycling network in the Objective 2 rural areas expected to be implemented by 2008;

Development of Cultural routes (on wine and religion);

Agrotourism: An incentive scheme for small and medium enterprises was introduced in May 2005 for the encouragement of investment in agrotourism. It provides for grants for the restoration of traditional houses, their conversion into accommodation units, restaurants, workshops, museums and other investments contributing to the enrichment of the agrotourism product.

Rural areas marketing plan supporting private and public investments in the Objective 2 rural areas. It will be implemented by 2008.

- Additionally, action plans for the development of the following priority market segments are being prepared: conferences and incentives, medical, cultural tourism, religious tourism, sports and training, cycling, golf and other special interest tourism, including nature tourism, diving sea and beach activities and learning holidays.
- Measures towards the upgrading of the accommodation and catering facilities.

Hotel establishments - Provision of incentives for the upgrading and/or withdrawing of low category accommodation;

Catering establishments - Rationalization of the classification system and regulatory framework for the development of catering establishments.

Human resource development - Setting up a framework for the development of professional qualification standards.

- Quality and environmental systems/mechanisms - Incentives for the adoption of quality and environmental standards in tourist establishments (ISO 9001, 14001, HACCP, Green Globe).
- A scheme will be introduced in 2006 targeted at SMEs, for investments in tourist enrichment projects - The objective is to develop up to 12 big projects “Tourism Attractors” and up to 24 smaller ones “Special Interest Projects” which capitalise on the unique characteristics and comparative advantages of each region and contribute towards the attraction of special target markets, the enrichment of the tourist product and the creation of opportunities for a diversified tourist experience.

1.3.3. Enhancement of the Competitiveness of the Manufacturing Sector

Measures underway / planned

The industrial policy pursued, has the following main objectives:

- Enhancement of the competitiveness of the sector;
- Improvement of the business environment;
- Enhancement and modernisation of the traditional manufacturing sector;
- Enhancement of research, technology and innovation;
- Attraction of capital intensive foreign investment.

Beyond the measures covered elsewhere in the paper (concerning the promotion of R&D activities, the promotion of innovation and entrepreneurship), the following measures are being promoted in the manufacturing sector:

- Government Guarantee Scheme for loans granted to SMEs, which do not have adequate collateral to obtain loans.
- Provision of grants for the technological upgrading of small and medium enterprises. The scheme started to be implemented in April 2005 and it will continue up to December 2006.
- Grants for the creation of viable business units in rural areas. (Objective 2 areas of the Structural Funds).
- Operation of a Council of Industrial Development as from 2005.

1.3.4. Enhancement of the Production Base of Disadvantaged Areas

Measures underway / planned²³

With a view to enhance the production base of disadvantaged areas (rural and mountainous areas and inner parts of urban centres) the following two programmes, co-financed from EU funds, are being implemented:

- Implementation of the Objective 2 Programme of the Structural Funds;
- Implementation of the Rural Development Plan, co-financed from EU funds.

2. Promotion of R&D, Innovation and Facilitation of ICT diffusion

2.1. Increase and Improve Investment in R&D, in particular by Private Business²⁴

2.1.1. Current Situation

Cyprus ranks very low in terms of R&D expenditure, however an increasing trend has been observed over the past years, attributed mainly to a considerable expansion of the research activities of the

²³ More details as to the specific programmes as well as the use of the Cohesion and Structural Funds in support of the Lisbon objectives are presented in Annex 2. The schemes with a view to developing and marketing rural tourism are presented in the section on upgrading and enriching the tourist product above.

²⁴ The following text refers to the Integrated Guideline No. 7.

broader public sector. R&D expenditure in 1992 was only 0,18% of GDP, while in 2003 this figure increased to 0,35%. The major part of expenditure, 72%, comes from the public sector.

The main research activities focus on the areas of agriculture and health. Most research activities undertaken are applied ones.

This increasing trend of R&D expenditure during the last decade is attributed to a number of factors and developments such as:

- the operation of the University of Cyprus as from 1992;
- the participation of Cyprus in the EU Research Framework Programmes, which brought forward a new dimension for the entire sector;
- the considerable expansion of research activities of two internationally recognised research institutions of Cyprus, namely, the Institute of Neurology and Genetics and the Agricultural Research Institute; and
- the creation of the business incubators initiative of the Government, aiming at the encouragement of new, high technology enterprises.

Meanwhile, the establishment of the Research Promotion Foundation (RPF) – a non-profit organisation fully supported by the Government, with the mission to develop, implement and manage all national research programmes – proved to be one of the most decisive and successful parameters.

The main instrument, through which the national policy is applied, is the National Framework Programme for Research and Technological Development, designed and managed by the Research Promotion Foundation. The Framework Programme covers, inter alia, the support of multi-thematic research projects in pre-selected fields, and the encouragement of cooperation between research institutions and enterprises, the creation of Public Private Partnerships ('PPPs') and the development of new products and services for the benefit of Cypriot enterprises in all economic sectors. In addition, it provides for the upgrading of existing and the built up of new research infrastructure, as well as the promotion of research collaborations and the exploitation of human research potential of Cyprus.

The development of R&D activities is still constrained by a number of factors such as, the small size of the Cypriot enterprises; the insufficient research infrastructure; the weak links between research organisations and enterprises; and the lack of research culture, a phenomenon that is directly linked to the late establishment of academic institutions;

On the other hand, Cyprus has a number of strengths, accruing from the high quality of its scientific manpower and its ability to utilise the extensive pool of its distinguished expatriate scientists. Moreover, the telecommunications infrastructure, which enables the easy access to international research networks, together with the high standard of living in Cyprus, could attract foreign scientists.

2.1.2. Challenges – Policy Priorities

The first key challenge is to increase substantially R&D expenditure. In this respect, the Government of Cyprus has set as a target for R&D expenditure to reach 0,65% of GDP in 2008. Other key challenges that the national research policy needs to take up, are:

- The upgrading of existing and the building of new research infrastructure;

- The encouragement of involvement of the private sector in R&D activities. The small size of enterprises and the weak links between research organisations and private enterprises hinder the involvement of private business in R&D;
- The generation of a critical mass of researchers, through the development of researchers' careers, the encouragement of mobility of researchers and the enhancement of research capacity;
- The promotion of research culture within all levels of the educational system;
- The further promotion of competitive alliances between the Cypriot and the European research community, for securing funding from EU RTD programmes.

The national policy in the area of R&D aims at overcoming the factors constraining R&D development and contributing towards the further diversification of the economy. In order to achieve the targets set, a big leap is necessary; the substantial increase of government budget in R&D will contribute significantly to this end, but this will be insufficient; hence, a policy mix is needed that will boost private involvement in R&D.

The Government of Cyprus has developed a wide range of policy initiatives and measures, in order to respond to the challenges listed above. A policy mix will be implemented, comprising specific measures ranging from fiscal measures, to funding of research infrastructures, and the promotion of national programmes that aim at the involvement of private sector in R&D activities.

The measures have been grouped into four policy priority areas:

- **Strengthening the scientific base;**
- **Reinforcement of private sector participation in R&D;**
- **Enhancement of Human Resources;**
- **Promotion of International Cooperation.**

The horizontal measure of increasing overall public spending in R&D as well as the National Framework Programmes for Research and Technological Development, designed and managed by the Research Promotion Foundation, are part and parcel of all the above policy priority areas.

2.1.3. Policy Initiatives

2.1.3.1. Horizontal Measures

Measures underway / planned

- Increase overall (public and private) spending in R&D to 0.45% of GDP in 2005 and 0.65% for 2008.
- The implementation of a new RPF Framework Programme for Research and Technological Development 2006-2008²⁵, substantially upgraded in comparison to the ongoing FP. The total expenditure involved in the new FP is expected to reach CY£50 mln, whereas the RPF's contribution will be of the order of CY£30 mln.

²⁵ The current framework programme of RPF is described in the previous section ("Current Situation").

2.1.3.2. Strengthening the Scientific Base²⁶

The scientific base of Cyprus will be enriched through measures aiming mainly at the enhancement of research infrastructures.

Measures underway / planned

- Establishment of a Research and Training Institute in Cyprus on public health and environmental issues in co-operation with Harvard University: The institute will offer top quality training and research, and will develop direct links with regional policy-makers in the fields of environment and public health.
- Establishment of the Institute of Cyprus: The institute will be a regional research and educational centre of excellence. The first Research Centre of the Institute is expected to operate at the beginning of 2007, whilst the project will be completed by 2012.
- Strengthening the RPF funding Programme aiming specifically at upgrading research infrastructure in Cyprus²⁷: This Programme concerns the development of new research infrastructure, the development and strengthening of existing research units/laboratories and the development of research infrastructure networks.
- Institutional and competitive grants to public sector research institutions: Within the framework of the 2005 national budget, the government has redirected the method of funding of public research institutions, including the University of Cyprus, by reducing relatively their direct financial support, and increasing the funds that are available for the financing of competitive proposals, via mainly the RPF. This method will be adopted in all future budgets in order to promote high quality research and enhance scientific excellence.
- Establishment of the Technological University of Cyprus ('TUC'): The Technological University of Cyprus is expected to begin its operation in September 2007.
- Evolution of private colleges of tertiary education to private universities: Following the enactment of a relevant Law by the House of Representatives in July 2005, it is anticipated that a number of private colleges of tertiary education will be upgraded, and hence, intensify their research activities.
- New RPF funding programme for the identification and support of Cypriot Research Centres of Excellence: This programme is designed to support top-level research activities undertaken by Cypriot Organisations, which will be classified as Cypriot Centres of Excellence.
- Study for the operation and management of public research institutions²⁸: The RPF will undertake a study for the assessment of the strengths and weaknesses of the main research institutions in Cyprus, as far as their operation, management and infrastructure, are concerned.

2.1.3.3. Reinforcement of Private Sector Participation in R&D²⁹

Measures underway / planned

- The RPF funding Programmes aiming at the improvement of competitiveness of Cypriot enterprises³⁰: These Programmes aim to involve Cypriot enterprises in research activities in order to develop new products and services and new or improved methods of production. They

²⁶ This category covers themes under Policy Priority Areas 2, 3 and 5 of Guideline No. 7.

²⁷ Programme under the RPF FP 2003-2005.

²⁸ This measure covers issues under Policy Priority Area 5 of Guideline No. 7.

²⁹ This category covers issues under Policy Priority Area 4 of Guideline No. 7.

³⁰ Programmes under the RPF FP 2003-2005.

support the cooperation of Cypriot enterprises of all sectors of economic activity with the academic/research institutions in Cyprus or abroad, and aim at creating powerful and productive links between enterprises and academia. Enhanced emphasis will be given to these programmes in the new Framework Programme 2006-2008 of the RPF.

- The new RPF Framework Programme for Research and Technological Development 2006-2008: One of its main objectives will be the establishment of close collaboration between enterprises, their associations and academia.

2.1.3.4. Enhancement of Human Resources³¹

It is considered essential to create a critical mass of researchers in areas where the specific needs of Cyprus concentrate, through the enhancement of researchers' careers, the encouragement of mobility of researchers and the promotion of a research culture within all levels of the educational system.

Measures underway / planned

- The RPF programmes for developing the human potential in research: The ongoing "Programme for the Support of Young Researchers" contributes to the creation of research career opportunities for young scientists. Moreover, the RPF has launched two Programmes for the engagement of young and experienced Cypriot expatriate researchers in projects. These programmes will be also included in the new FP 2006-2008.
- Initiatives for promoting research culture within the educational system: So far, the RPF has developed the Competition "Pupils in Research" and the "Research Competition for Undergraduate Students", which promote the involvement of young people in research. These programmes will be also included in the new FP 2006-2008.
- Development of a Mobility Centre: The RPF will host the Mobility Centre in Cyprus within the framework of the mobility strategy for the European Research Area ('ERA'). The Centre will provide all the necessary information to interested researchers (regarding visa and entry conditions, social security and taxation, recognition of diplomas etc). The RPF is also in the process of developing the National Mobility Portal on the existing/operating RPF website. The aim of this portal will be to continuously provide updated information regarding research opportunities in Cyprus for foreign researchers, as well as information on legal, administrative and cultural matters. It will also provide links to the European Researchers Mobility Portal ('RMP') and other European portals in order to encourage Cypriot researchers to pursue research opportunities in other European countries. Both the Mobility Centre and the National Mobility Portal will be available to the public in 2005.
- Collaboration with Expatriate researchers: The Expatriate Researchers Programme of RPF (2003-2005) seeks to attract distinguished Cypriot researchers living abroad and employ them, for specific periods of time, in research organisations in Cyprus. This programme will be also included in the new FP 2006-2008.
- Collaboration of the Cyprus research community with distinguished researchers abroad: This RPF Programme is expected to facilitate the transfer of knowledge and experience from distinguished scientists, to the Cypriot research community, as well as the creation of long-term cooperation networks between local research units and teams of these scientists, for future participation in Cypriot and international Programmes. The programme was launched in February 2005.

³¹ This category covers issues under Policy Priority Area 6 of Guideline No. 7.

2.1.3.5. Promotion of International Cooperation

Measures promoting international cooperation focus on the establishment of networks and the participation in EU and other programmes, with the aim of transferring of knowledge and facilitating the mobility of researchers.

Measures underway / planned

- Promotion of the participation to the 6th and 7th Framework Programmes for research and technological development: The government has implemented measures to support Cypriot researchers, enterprises, and institutions to participate in these programmes. These measures include: the setting up of a network of National Contact Points; a special incentive scheme that encourages the participation of civil servants to the programme; the reimbursement of expenses incurred by Cypriot researchers during the preparation stage of a proposal that has been submitted in the FP6 and was assessed as eligible for funding. These measures will be strengthened during the 7th Framework Programme.
- Bilateral agreements with other countries in the field of research.
- Access to international research infrastructures: A new RPF funding programme provides to the research community of Cyprus the opportunity to access advanced, international research infrastructures, in order to implement high-level research activities. The programme was launched in February 2005.

2.2. Facilitate All Forms of Innovation³²

2.2.1. Current Situation

The same factors as in R&D constrain the development of innovation: the small size of enterprises, the low level of technology in the private sector and the small number of graduates in science and engineering fields.

As a result, the performance of Cyprus in the area of innovation is low by international comparison. The Summary Innovation Index of Cyprus (SII) was at 0.17 for 2004 while the corresponding EU average was 0.33.

2.2.2. Challenges – Policy Priorities

The key challenges for Cyprus with respect to innovation are to:

- enhance the endogenous capacity of companies to innovate and to channel the diffusion of innovation;
- close the gap between research, innovation and commercialisation of innovative activities and to channel the diffusion of innovation;
- further develop finance mechanisms that encourage investment in innovative activities;
- create an innovation culture.

In order to tackle effectively these challenges, the Government of Cyprus is promoting a series of measures. The measures have been grouped into three main policy priority areas, as follows:

³² The text refers to Guideline No. 8 of the Integrated Guidelines.

- Creation of innovation poles and incubators;
- Provision of innovation support services;
- Improved access to finance and foreign direct investment.

2.2.3. Policy Initiatives

2.2.3.1. Creation of Innovation Poles and Incubators³³:

Measures underway / planned

- Business incubators: Up to date four business incubators have been established. Through these institutions the necessary support, including financial support is given to new inventors and researchers in order to develop and commercialise their innovation ideas.
- Establishment of a Science and Technology Park: The Ministry of Commerce, Industry and Tourism (MCIT) has established a cooperation with the French Riviera Chamber of Commerce and Industry and the authorities of the Sophia Antipolis Science Park, with a view of establishing a Technology Park in Cyprus, which will host research centres of international repute and esteemed high tech enterprises. A feasibility study will be assigned by the end of this year and it is expected to be completed by the end of 2006.
- Thematic Networks and Innovation Networks: These measures aim at the creation of Networks of Cooperation between enterprises, research organisation and intermediaries.

2.2.3.2. Provision of Innovation Support Services³⁴:

Measures underway / planned

- Design of the Regional Innovation Strategy for Cyprus (RISC), aiming to address the weaknesses of the innovation system in Cyprus. The Action Plan elaborated on the basis of this strategy, will be gradually implemented over a period of five years starting from the year 2006.³⁵
- Awareness – Training of SMEs for the Development and Utilisation of Innovation Opportunities.
- Research & Development Intermediate System. The measure aims at creating a mediation mechanism that will operate between research/academic institutions and enterprises, with a view to bridge the gap between the production and demand for innovation. The system will start in 2006.
- Awareness Campaign (to business and public) for Innovation and R&D: The measure aims at the creation of an innovation culture not only in the Cypriot enterprises but also in the Cyprus society in general. The campaign is expected to be carried out in 2006.

³³ This category covers themes under Policy Priority Areas 1 and 2 of the relevant Guideline

³⁴ This category covers themes under Policy Priority Area 1 of Guideline No. 8.

³⁵ The measures listed below are included in the Action Plan.

2.2.3.3. Improved Access to Finance and Foreign Direct Investment³⁶

Measures underway / planned

The Government, in an effort to facilitate access to finance and foster a more entrepreneurial culture and encourage more people to create their own business, has introduced and will continue the operation of the following schemes:

- Scheme for the encouragement, strengthening and reinforcement of Women's Entrepreneurship.
- Scheme for the encouragement, strengthening and reinforcement of Youth Entrepreneurship.
- Loan Guarantee Facility that will facilitate the financing of viable projects promoted by SMEs, which otherwise could not be implemented, due to the lack of collateral. It is expected to be set up in 2007.

2.3. Facilitate the Spread and Effective Use of ICT and Build a Fully Inclusive Information Society³⁷

2.3.1. Current Situation

The development of the ICT culture is placed at the centre of the efforts for the development of a knowledge-based society, as the diffusion of ICT constitutes an important driver in improving productivity. Within the past few years, the Cypriot economy exhibited noteworthy progress in a number of areas, such as the substantial increase in computer ownership and internet access from households and enterprises, the provision of online public services and the improvement of infrastructure in schools. However, there remains a vast potential for higher utilisation of the opportunities offered by the information society.

The current situation, more specifically, is as follows:

Internet Access, Broadband Infrastructure

During the past few years there has been a substantial increase in mobile subscriptions, computer ownership and internet access from households and enterprises. For the year 2004 in particular, mobile usage in Cyprus was more than 85% of the inhabitants, showing a great potential for the development of m-services; internet penetration for enterprises reached 88%, whilst the number of households with PCs and Internet access increased to 43% and 29%, respectively.

Currently, there are five internet service providers, offering a wide range of services. The cost for the user for accessing the Internet is considered to be quite low. However, the take up and provision of broadband services and faster internet access is still limited, although growing. Broadband services have been provided since 2001. Today, only the Cyprus Telecommunications Authority (CYTA) offers this type of services, and its ADSL network covers all urban areas (65% of the population), whilst network expansion to rural areas started at the end of 2004. The cost of ADSL for households is

³⁶ This category covers themes under Policy Priority Area 5 of the Guideline No. 8.

³⁷ The following text refers to the Integrated Guideline No. 9.

relatively low³⁸, whilst the ADSL cost for businesses is quite high, although a significant decrease in prices has been observed in the last two years³⁹.

Moreover, the two GSM operators (CYTA and Areeba) have been granted the right to establish and operate 3G/UMTS network and provide 3G/UMTS services. Areeba has been offering 3G/UMTS services since December 2004 but the penetration is very low at the moment, whilst CYTA has begun rolling its 3G/UMTS network as well.

e-Government

In 1998 the Government initiated an “Information Systems Strategy”, a masterplan for the computerisation of all Ministries and Government Departments. During recent years, a great improvement has been achieved not only in the number but also in the level of the public services provided through the web. Most of the Government Ministries/Departments/Services have their own websites. The majority of the websites is informative and provides downloading of forms and other documents. Some also support user interaction. Appreciating the need for combating e-exclusion, public web pages are developed on the basis of the Web Accessibility Guidelines.

The process of developing web-enabled systems in order to provide on line and better services to the public is underway. The following are the information systems which already provide online services to the public:

- Taxisnet provides the facility to the Cypriot Taxpayers to submit their tax returns electronically through Internet.
- THESEAS system allows traders, or their authorized agents, to submit through the Internet their custom and import declarations for the clearance of goods.
- The Candidate Placement System enables job seekers, registered at the local District Labour Offices, to search and locate available jobs, post their CVs online and manage their job applications. It also allows employers to publish and manage job vacancies.
- The Road Transport System provides online services regarding car registration, car information and drivers license availability.
- The Identification and Registration of Sheep and Cattle system allows authorised users/cattlemen to submit and retrieve information (reports) regarding their sheep and cattle through the internet.

Regarding the use of online public services, significant progress has been made. The table below shows the usage of the Internet for interaction with public authorities for individuals and enterprises for the year 2004.

	Enterprises (%)	Individuals (%)
Obtaining information	34.8	10.4
Downloading forms	24.3	3.5
Returning filled in forms	11.0	1.4

³⁸ There are three products offered for households and their prices range from CY£9 to CY£15 monthly rental, whilst connection charges are fixed at CY£40. (Source: www.i-choice.cyta.com.cy).

³⁹ Two business products are offered, and their prices range from CY£40 connection charges and CY£30 monthly rental to CY£100 connection charges and CY£45 monthly rental. In 2003 only one product was offered and its price was CY£100 connection charges and £52 monthly rental (prices do not include the rental of the telephone line, the ISP fee, and the VAT). (Source: www.i-choice.cyta.com.cy).

e-business

The successful implementation of e-business contains both the development of e-commerce and the improvement of enterprises' internal efficiency. The use of ICT applications by enterprises is a significant tool for achieving the e-business objective.

Based on the indicators shown in the table below, it is evident that e-business in Cyprus has not been developed; business to business activities are quite limited, e-commerce is almost non-existent, and individuals use their Internet connection mainly for communication purposes and information search.

	2004
% of enterprises with a website/homepage	44.7%
% of enterprises using the web for banking and financial services	44.9%
% of enterprises having purchased online at a significant level (more than 10% of purchases)	6.5%
% of enterprises having received orders online at a significant level (more than 10% of sales)	2.7%
% of individuals using the Internet for banking and financial services	4.1%
% of individuals having bought goods or services for private use over the internet	4.3%

Inclusion (e-Learning, Life-long Learning, Electronic Literacy)

In the past five years, Cyprus has achieved some progress in the field of e-learning, life-long learning and electronic literacy.

As shown below, there is a considerable increase in the number of PCs available to pupils during the last years. Moreover, 81% of PCs in primary education have internet access, whilst the respective percentage for secondary education is at 63%.

	2002	2003	2004	2005
Primary education:				
- computers per 100 pupils	5.4	5.6	7.3	9.4
- computers connected to the internet per 100 pupils	0.6	4.8	5.9	9.4
Secondary education:				
- computers per 100 pupils	10.8	12.1	16.0	22.1
- computers connected to the internet per 100 pupils	5.1	5.5	10.0	17.1

It is further noted that:

- All schools of primary education are connected through intranet since 2004.
- Primary, secondary and vocational education offer evening and night programmes, providing the opportunity to early school leavers to get their upper secondary education diploma, and to the labour force to be trained in new technologies and other topics related to the new occupational needs of the market.

Quality of Life (e-Health)

Cyprus is at a very initial stage of using ICT applications in the health sector. There is no integrated health system, very low usage of PCs in health centres, whilst the IT infrastructure of the Ministry of Health (MOH) is inadequate for the utilisation of the huge amount of information and data. This leads to inefficient administration of resources available, increased bureaucracy and restricted potential in the provision of quality health services.

In its efforts to introduce e-Health in Cyprus, the Ministry of Health has initiated the deployment of promising pilot projects in collaboration with the University of Cyprus, through which two successful e-Health projects have been completed:

- a) DITIS (Network of Medicine Tele-cooperation for Home Care) is a healthcare system that enables the effective management and co-ordination of healthcare teams for the continuous assessment, diagnosis and treatment of patients. Through DITIS healthcare providers can have access to electronic patient information from anywhere and anytime via computer or mobile devices.
- b) Portable medical device for emergency telemedicine. The system enables the transmission of critical bio-signals such as the electrocardiogram, blood pressure, heart rate, temperature and still images of the patient, from the emergency site to the hospital.

Security

Although Cyprus does not face serious security problems at present (see table below), the Network and Information Security ('NIS') is a prerequisite not only for increasing the usage of ICT by households and enterprises, but also for the expansion of e-commerce. Hence, the Government demands from tenderers to ensure that the required security is in place.

	2004
Individuals with internet access having encountered security problems:	
computer viruses	9.1%
payment card fraud	0.3%
abuse of personal data	1.4%
Enterprises with internet access having encountered security problems:	
computer viruses	27.6%
abuse of data and/or systems of the enterprise	1.6%

2.3.2. Policy Priorities

The major policy priorities of Cyprus with regard to ICT are:

- Further promotion of eGovernment;
- Promotion of eBusiness;
- Upgrading of Education / Life-long Learning / Electronic Literacy – eLearning;
- Improvement of the Quality of Life – eHealth;
- Expansion of Broadband Access and Network.

It is noted in this respect that a National Information Society Strategy has been prepared aiming at utilising the opportunities offered by the Information and Communication Technologies. The Strategy

is structured in accordance with the three guiding priorities proposed by the European Commission in the “i2010” Initiative.

2.3.3. Policy Initiatives

Measures underway / planned

2.3.3.1. Horizontal Measures

- Review of the National Information Society Strategy.

Security

- Policy on Network and Information Security: A policy paper on the Network and Information Security (NIS), is planned to be adopted by the Ministry of Communications and Works (‘MCW’) at the beginning of 2006.

2.3.3.2. eGovernment

The roadmap for major web-enabled systems is currently as follows:

- The Government portal, through which the public will have access to various government information and services from a single point of entry is expected to be operational by the end of 2005.
- All Government Ministries/Departments/Services will maintain their own website by the end of 2005.
- The Social Insurance system, which will provide online services regarding the payment of the social contributions for employees or for the self-employed, is expected to be available in October 2005.
- The Government Gateway, which will provide security, authentication, encryption and decryption services is currently under study, and is expected to be completed within 2007.
- The Civil Registration System, which will provide on-line services regarding birth/marriage certificates, passports issuing, etc., is currently under study and it is expected to be completed by the year 2007.
- The Companies Registration System and the Land Information System are also under study and they are expected to be available to the public by 2007.

Apart from the above measures, future priorities include the development of more web-enabled systems, the creation of government-wide data warehouse, the completion of the rollout of the Office Automation System, and the delivery of e-services over public kiosks and mobile devices.

- Training of civil servants to help them develop an e-culture.

2.3.3.3. eBusiness

- Action Plan for eCommerce: The Ministry of Commerce, Industry and Tourism will initiate the implementation of an Action Plan for the deployment of eCommerce in Cyprus.

2.3.3.4. Inclusion (e-Learning, Life-long Learning, Electronic Literacy)

- Improvement of Infrastructure:
 - Personal Computers: the target set by the Ministry of Education and Culture (MOEC) is that by 2007 the ratio of computers to the number of students will be 1:4 for the primary education and 1:3 for the secondary education.
 - Internet: all PCs at schools will have internet access by 2007.

- Projectors: At present, only the computer labs have projectors in the secondary education. By 2010, it is planned that each classroom will have its own projector.
- Intranet: It is planned that all secondary education schools will be interconnected through intranet by the year 2007.
- Training of teachers in IT technologies: the purpose of the training is to provide teachers with basic IT skills. Every teacher will have the opportunity to attend more advanced training programmes.
- Reform of the educational curriculum to include use of ICT tools:
- Certification of skills on ICT according to European standards for Gymnasium third grade pupils. The implementation will start in the school year 2006-2007.
- Use of multimedia in teaching. It is anticipated that multimedia will be used in most of the lessons by 2008.

2.3.3.5. Quality of Life (e-Health)

Introduction of an Integrated Health Care Information System ('IHCIS'): The application of the IHCIS is at its final stage. It is envisioned that some software modules will start operating in the new Nicosia General Hospital and the Famagusta General Hospital at the beginning of 2006. The Ministry of Health intends to roll-out the IHCIS to all hospitals and medical centres in the public sector by 2010, provided that the pilot implementation will be successful.

2.3.3.6. Expansion of Broadband Access and Network

- Introduction of digital terrestrial television broadcasting: The overall policy framework will be finalized after consulting all interested parties.
- Fixed Wireless Access Networks: For the introduction of Fixed Wireless Access ('FWA') networks in Cyprus, a public consultation will first be conducted to explore relevant issues, such as the number of licenses to be granted, the regulatory framework, geographic coverage and network roll-out requirements. The public consultation is expected to be launched in the fourth quarter of 2005.
- TETRA Networks: The decision for granting licenses for TETRA networks has already been taken. The next step is to conduct a public consultation to define the number of licenses to be granted, the geographic scope of each license and the policy framework, especially in relation to public safety and commercial services.

3. Promotion of Structural Reforms Targeting at Enhancing Competition and Improving the Overall Business Climate⁴⁰

This section covers primarily the structural reforms targeting at enhancing competition and improving the overall business climate.

⁴⁰ This section covers mainly Guidelines No. 13 and No. 14.

3.1. Further Enhancement of the Conditions of Competition

3.1.1. Current Situation

As far as the conditions of competition are concerned, the Cyprus market, despite its small size, is characterised by conditions of intense competition, as reflected in the relative large number of small enterprises operating in the various sectors of economic activity.

In the financial sector conditions of intense competition have been intensified over the past few years, via the process of liberalisation of capital movements. In both the banking and the insurance sector, significant foreign presence continues to be present, which is expected to further increase in the near future.

In contrast, competition was absent, till very recently, in the utilities sectors of telecommunications and electricity. The situation is gradually changing with the liberalisation of the sectors, however, time is required for the new network/service providers to gain significant market shares. The conditions of competition were also restrained in the air transport sector; the liberalisation of the sector as from 1.5.2004 has already changed significantly the conditions of competition, particularly for popular destinations.

The Commission for the Protection of Competition (CPC) is the administrative body for regulating ex-post competition issues in Cyprus. The CPC examines cases of suspected breaches of the Law on its own initiative or upon complaint. In the telecommunications and postal services sector as well as in the energy sector separate sector-specific Regulatory Authorities have been set up and assigned ex-ante regulatory competencies with a view to secure ex-ante conditions of fair competition.

The specific situation in the utilities sectors is as follows:

3.1.1.1. Utilities Sectors

All hindrances to market access in the sectors of telecommunications, postal services, electricity and air transport have been removed and the sectors have been liberalised, at the latest as from 1.5.2004, the date of Cyprus's accession to the EU. Moreover, the liberalisation in the sectors of telecommunications and electricity necessitated also the elimination of cross subsidisation and thus a tariff re-balancing, so that the prices of the rendered services reflect their actual cost. The liberalisation of the telecommunications and energy sectors is leading to enhanced investment opportunities also for foreign investors (partly already seen) and an increase in the volume of production, improvements in quality, wider choice for consumers and containment of prices, with positive repercussions on growth and employment. The containment of the cost and better quality of the services rendered by the utilities' sectors will have a positive impact on the overall competitiveness of Cypriot goods and services, as the services of the utilities sectors constitute intermediate inputs in other sectors of economic activity.

3.1.1.1.1. Telecommunications and Postal Services

In the time that elapsed since the liberalization of the sector, over 50 companies were licensed under the Regime of General Authorisations for services/network provision.

In the area of mobile telephony, the Regulator awarded, through auctioning a second 2G/3G license to Areeba (a company of Lebanese interests) in October 2003, which started offering mobile phone services as from September 2004. As far as fixed telephony is concerned, 23 licences for the provision of fixed telephony services have been awarded, and as from the summer of 2003 fixed telephony services are offered from other suppliers beyond CYTA.

Due to the short period that elapsed, the market share of the new providers seems to be still very low. It is noted that the incumbent operator (CYTA) has been determined by the Regulator as having significant market power, under the 1998-2000 Regulatory Regime, in public fixed telephony services, public fixed network, public mobile telephony, public mobile network, leased lines and interconnection.

As far as the Postal Services market is concerned, it was de facto liberalised long before; as a result a large number of private companies entered the market and were operating on competitive terms.

3.1.1.1.2. Electricity Sector

In the electricity sector, the liberalisation provisions of the harmonised with the acquis Cypriot legislation came into effect as from 1.5.2004, i.e. the date of Cyprus's accession to the EU. As from that date, 35% of the electricity market was opened to competition, in line with the minimum requirement of the electricity Directive 96/92/EC.

Regulatory Authority: Due to the short period that elapsed since the liberalization of the market, no new suppliers have entered the market. However, the Regulatory Authority for Energy has received a number of applications and has awarded a number of licences for the setting up of small electricity producing units mainly for electricity generation from RES.

It is also noted that significant structural changes have taken place in the oil sector. All import controls have been lifted. In addition, the system for regulating oil prices was abolished by a new law that became effective in May, 2004. Under the new law, prices have been fully liberalised.

3.1.1.1.3. Air Transport Sector

In the air transport sector there were, till accession to the EU, restrictions for scheduled flights and outgoing chartered flights, whereas incoming chartered flights operated essentially without restrictions as from 1986. The sector was fully liberalised as from 1.5.2004. The liberalisation has already affected the main routes to Greece and London, whereas at the same time a fall in fares has been observed. The increase in the number of flights and the fall in fares is expected to benefit tourism and the export oriented services.

3.1.2. Policy Priorities

The main policy priority is the following:

- Further enhance the conditions of competition particularly in the sectors in which it is limited, such as in the electronic communications and electricity markets.

3.1.3. Policy Initiatives

Measures underway / planned

3.1.3.1. Horizontal Measures


- Further enhancement of the administrative capacity of the CPC.

3.1.3.2. Telecommunications

Aiming at the enhancement of competition in the Electronic Communications Market, the Office of the Commissioner of Electronic Communications and Postal Regulation (OCECPR) has taken the following regulatory measures:

- The incumbent operator has been designated as a Significant Market Power ('SMP') under the 1998-2000 Regulatory Regime and has been obliged to publish a Reference of Unbundling Offer ('RUO' - allowing the use of the network of CYTA till the final user). Two alternative operators have signed an agreement for Local Loop Unbundling (LLU) so far, and they are proceeding with pilot projects.

Measures underway / planned

- The OCECPR has initiated market analysis for 4 markets concerning mobile telephony (2), local loop unbundling and broadband services. Following the market analysis of the aforementioned markets, regulatory remedies will be taken by the OCECPR to promote competition in the electronic communications market. The relevant regulatory measures are expected to be imposed on the designated SMP operator at the beginning of 2006.
- During 2006 it is expected that the OCECPR will proceed with the analysis of the remaining of the 18 relevant markets defined by the Commission.
- Audit the incumbent's costing system by the end of 2005 to determine the cost of wholesale/retail services.
- Preparation of a draft policy paper by the OCECPR on promoting broadband competition and increasing broadband services penetration, which will be submitted to the Ministry of Communications and Work  the end of 2005. Implementation of agreed policies in the period 2006-2007.

3.1.3.3. Energy sector

Measures underway / planned

- The Cyprus Energy Regulatory Authority (CERA), with a view to facilitate competition, allows exemption from the licensing process of all plants of less than 1MW production capacity, using conventional means and up to 5MW from RES. In addition, supply of electricity up to 500KW for every single production plant is exempted from the licencing process.
- CERA will set the charges for using the grid by the end of 2005, so that other suppliers may use it for the provision of electricity.
- Undertaking of a campaign by CERA, in 2006, informing eligible customers on the procedures and conditions in choosing electricity suppliers.

3.2. Change of the Status of the Organizations in the Utilities Sectors

3.2.1. Current Situation

As already mentioned, competition was absent, till very recently, in the utilities sectors of telecommunications and electricity whereby there was a monopoly status, the only suppliers in the markets being semi-governmental organizations. In contrast, the postal services market, was de facto liberalized over a long period of time, whereas the universal service provider – the Postal Services Department, continues to be a department of the Ministry of Communications and Works.

3.2.2. Policy Priorities

The main policy priority is the following:

- Change the status of the organisations in the sectors of telecommunications (Cyprus Telecommunications Authority - CYTA) and postal services (Postal Services Department of Ministry of Communications and Works) with a view of enhancing their flexibility and enabling them to cope with the pressures of the new liberalised environment.

3.2.3. Policy Initiatives

3.2.3.1. Telecommunications sector

- Change of the status of CYTA aiming at making CYTA a flexible and efficient organization with business and operational autonomy so as to operate on equal terms with other private telecommunication organizations. The changed status aims at safeguarding:
 - More flexibility in decisions concerning annual budget investments, conclusion of strategic coalitions and pricing of services;
 - More flexibility in matters concerning personnel;
 - Flexibility in tenders for purchase of services and equipment.

A bill entitled the Operation of CYTA Law of 2005 is now under the legal vetting process, changing the status of CYTA, according to the above mentioned principles.

3.2.3.2. Postal Services

- Change of the status of the Postal Services - The Council of Ministers decided to proceed to the change of the legal status of the Postal Services from a Government Department into a semi governmental organization with administrative and financial autonomy. Currently, consultations are underway between the trade union of civil servants, on the one hand, and the Department of Public Administration and Personnel and the Ministry of Communications and Works, on the other, towards this direction.

3.3. Increase the Efficiency of the Public Sector

3.3.1. Current Situation

A well functioning public sector is a decisive factor for the overall business climate within a country. Cyprus generally possesses a well functioning public administration. However, there is a significant room for improvement, taking into account the changed environment that Cyprus faces, following its accession to the EU.

Over the past few years Cyprus has managed to sufficiently staff a number of Ministries/ Departments that were in need of immediate enhancement of their capacity in order to be able to effectively implement the *acquis communautaire*, as well as to establish and sufficiently staff new, independent organizations, in line with the *acquis* (e.g. Internal Audit, Asylum Unit, Office for the Commissioner for Data Protection, Office of the Commissioner for Public Aid, Regulatory Authority for Telecommunications and Postal Services etc.).

3.3.2. Policy Priorities

The main policy priority is the following:

- The need to increase the efficiency of the public sector so as to be in a position to function effectively within the changed environment, resulting from membership in the EU, the globalization of the economies and the rapid technological changes.

3.3.3. Policy Initiatives

Measures underway / planned

The Government, with a view to increasing the efficiency of the public sector as well as enhancing transparency and accountability, is promoting a number of measures.

- Amendment of the Public Service Law to accelerate recruitment procedures - It is expected to be enacted by the end of 2005.
- Further modernisation of job schemes (which prescribe the general duties and responsibilities of an office/ post and the qualifications required).
- Code of Conduct for civil servants - A code of conduct is being developed in the civil service based on the relevant Code of Conduct of the European Council, which defines the responsibilities/ obligations and expected behavior of civil servants in the Cyprus civil service. It is expected to be ready by the end of 2006.
- New performance appraisal system - A new performance appraisal system in the public service has been developed in close co-operation with a private consultancy firm. The new system aims, amongst others, at:
 - Appraising performance in a fair, objective and consistent manner;
 - Evaluating the potential of employees for promotion;
 - Creating the necessary performance-oriented culture.

The new appraisal system is, currently, being negotiated / discussed with PA.SY.D.Y – the civil servants' trade union. The new system is expected to be implemented by 2006.

- Common Assessment Framework (CAF) - Efforts are being made to introduce the CAF (a quality management tool), on a pilot basis, in a number of public sector departments, that will assist them in promoting measures for improving their organisational performance and efficiency as well as the quality of the services provided to the citizens. Based on the results of the pilot introduction, the CAF will then be promoted, in a gradual manner to the whole the public sector.
- Develop one-stop-shops in the civil service, with the purpose of delivering better access to a series of government information and services, from one point of contact / location. The Ministerial Council already approved the setting up and operation of the first pilot one-stop-shop by the end of 2005.
- Continuous Training / Learning - Promotion of learning in the civil service (at individual, team and organizational level) with the development of decentralized capacity for managing learning on a systematic basis. The initiative was launched by the Cyprus Academy of Public Administration in October 2001 and will be implemented in a gradual manner.
- Direct provision of learning to civil servants by the Cyprus Academy of Public Administration (CAPA), the training institute for the Cyprus public service.
- Citizens' Charter and Citizen's Guides - As regards increased transparency and improvement of the relationship between citizens and the civil service, the introduction of a Citizen's Charter / Citizen's Guides in Departments / Services rendering services to the public is being promoted as from 2000; a number of them have already been developed. The measure will continue to be implemented aiming at the improvement of offered services to the citizens and to provide them with more in depth information.

3.4. Reduction of the Regulatory and Administrative Burden⁴¹

3.4.1. Current Situation

Market regulation is necessary so as to safeguard the effective functioning of the market mechanism and tackle market failures. However, the cumulative impact of regulations may impose substantial economic costs, via mainly an excessive administrative burden imposed on enterprises. It is therefore essential that regulations are well designed and proportionate. This is more imperative in the case of Cyprus, as the overwhelming majority of enterprises are very small, and hence more negatively affected by a complicated regulatory framework.

Currently, in Cyprus, the procedure for the creation or adjustment of the regulatory framework involves a wide consultation at the stage of drafting the legislation between the competent Government department and the relevant stakeholders, a legal vetting process undertaken by the Law Office of the Republic and further discussions and consultations at the level of the competent Parliamentary Committee. Within the framework of this procedure, the costs and benefits of the various legislative measures are broadly discussed.

⁴¹ It corresponds to Guideline No. 14.

However, there is neither the institutional framework nor the necessary expertise for a systematic and rigorous impact assessment of the economic, social and environmental impacts of regulations and measurement of administrative burden.

3.4.2. Policy Priorities

The major policy priorities in this area are the following:

- Develop awareness of the broader public sector, the businesses and the House of Representatives on the importance of a systematic impact assessment and measurement of administrative burden of existing and new legislation and of a generally well-designed and proportionate regulatory framework.
- Develop the institutional framework and the administrative capacity for a systematic impact assessment and measurement of administrative burden of existing and new legislation.

3.4.3. Policy Initiatives

Measures underway / planned

- Setting up of a task force to promote and continuously monitor the issue. The task force will be set up in the last quarter of 2005.
- Organisation of seminars on the issue, in 2005 and 2006 so as to increase the overall awareness on the need of a well-designed and proportionate regulatory framework.
- Elaboration of an action plan in 2006 and its gradual implementation. The action plan will include the following activities:
 - Study of best practices in member states of the EU in 2006.
 - Provision of technical assistance
 - Creation and staffing of a unit to this end, at central government level, for strategic guidance, technical assistance to implementing Ministries, monitoring progress etc.
 - Creation and staffing of units at the level of each Ministry
 - Development of a methodology for a systematic impact assessment and measurement of administrative burden of existing and new legislation.

3.5. Rationalisation of State-aid

3.5.1. Current Situation

In 2004 the level of state aid granted to all sectors of economic activity, with the exception of agriculture, stock farming and fisheries amounted to £90.27 mln or 1.25% of GDP as compared to £159.3 mln or 2.34% of GDP in 2003. The reason for the significant reduction of state aid in 2004 is the abolition, as from accession (1.5.2004), of all import duty reliefs granted for the import of large quantities of raw materials / machinery / equipment etc. used in the manufacturing industry. It is further noted that the above state aid levels include the state aid granted to the international business sector in the form of a lower corporate tax rate, 4.25%; according to the transitional period given to Cyprus by the EU, the international business sector could continue being taxed with a rate of 4.25% till the end of 2005. Should the international business sector be excluded, the level of state aid is reduced to £40.27 mln or 0.56% of GDP in 2004 as compared to £114.3 mln or 1.68% of GDP in 2003. Thus, in brief, the level of state aid has fallen in 2004 to the average level of the EU 15 for 2003.

Moreover, an analysis of the distribution of state aid in 2004, shows that 89.4% of the total corresponds to horizontal state aid, implying that the redirection of state aid towards horizontal objectives has been achieved to a great extent. Furthermore, it is noted that the bulk of the state aid is allocated to culture (60.4% of the total).

3.5.2. Policy Priorities

The main policy priority is the further rationalization of state aid towards those areas of intervention in which there is a clearly identified market failure.

3.5.3. Policy Initiatives

Planned Measures

- Carrying out of an interim evaluation of all existing state aid schemes by the implementing authorities with regard to the achievement of the set objectives, as from 2007.
- Carrying out of an ex ante evaluation for all proposed state aid measures to identify whether there is a market failure in the proposed area of intervention, as from 2007.

4. Expansion and Upgrading of Basic Infrastructures⁴²

As already pointed out, there are some deficiencies in the areas of transport, energy, electronic communications and the environment. The current situation and the tackling of the relevant deficiencies in the latter two areas are covered in the relevant sections on the information society and the environment. Hence, this section will concentrate on transport and energy.

4.1. Transport

4.1.1. Road Transport

4.1.1.1. Current Situation

Transport is served, to a large extent, by a modern road network, according to the indicators relating to the capacity, the physical and geometrical characteristics of the roads, the spatial layout and the transport needs of persons and goods.

Despite the considerable progress achieved in the completion of road networks at different levels and operation of the system, there are still weaknesses, the main ones being:

⁴² This section corresponds to Guideline No. 16.

- Inadequacy of road bypasses of large urban centres or other significant communities and the deficiencies relating to the connection of the national road network with the ports and airports;
- Traffic congestion in the urban areas at rush hours, mainly due to the rapid increase in the use of private cars, the low utilisation of public transport, and shortages in parking facilities;
- Comparatively high fatal and serious accident rates;
- Extremely low rate of usage of public transport with a continuous fall in demand and worsening of the level of services; high average age of public service vehicles;
- Insufficient infrastructure for environment friendly means of transportation (bicycle, pedestrians).

4.1.1.2. Policy Priorities

The main policy priorities in the road transport sector are the following:

- The expansion of the primary network in urban and inter-urban areas;
- The elimination of congestion in urban areas;
- Promotion of urban public transport system with the aim of increasing its share from 2% to 10% by 2015;
- Increasing road safety and achieving the target of halving the number of deaths and serious injuries by 2010.

4.1.1.3. Policy Initiatives

Measures underway / planned

Horizontal measures

- Implementation of a GIS based application to manage all the information relating to the road network. A Highway Information Management System based on a GIS is currently in the process of being populated by data, a process estimated to last for two years. Implementation of the system has already started, but its full benefits will be realised when all the data are inserted in the system.

Expansion of the primary network in urban and inter-urban areas

The main actions either underway or planned are the following:

- Upgrading of a highway and construction of a number of additional highways;
- Upgrading the Limassol roundabouts to fly-overs;
- Promotion of the construction of the Nicosia Perimetric motorway;
- Construction of new roads of regional importance.

The elimination of congestion in urban areas

- Undertaking of a study on Intelligence Transport System (ITS). Implementation of the ITS will start within the scope of an EU funded project in 2007.
- Implementation of measures for traffic management in urban areas based on the Nicosia Traffic Management and Public Transport Enhancement Study, which was undertaken in 2002.

Promotion of urban public transport

- A study to develop a Public Transport strategy is planned for 2007. It is expected that this study will tackle issues such as the renewal of bus fleet, bus priority schemes, parking strategies for the urban centres and pedestrian infrastructure investment. Implementation of the

recommended measures will begin in 2008 and financing will be sought from EU funds, such as the Cohesion Fund.

Increasing road safety

- Implementation of the Strategic Action Plan for Road Safety for the period 2005-2010.
 - A new study for the identification of black spots is planned to commence in early 2006 with a goal to implement all improvements necessary by the end of 2007.
 - Implementation of road safety measures, such as traffic calming measures, pedestrianisation, bus lay-bys, pedestrian crossings and cycle tracks.
 - Development of a new road safety culture, through road safety seminars.

4.1.2. Ports

4.1.2.1. Current Situation

Cyprus' ports have been developed into major cruise ship centres. On the contrary, their role as transshipment centres serving international third country trade has been declining. Following the accession of Cyprus into the EU, the need for expansion and upgrading of the port infrastructure has become imperative, as Cyprus ports are now the gateways of Europe in its southeast corner.

4.1.2.2. Policy Priorities

The major policy priority in the area of ports is the modernization and upgrading of the port infrastructure, its effective link to the Trans-European Networks and the transformation of Cyprus's ports into the gateways of Europe in the region.

4.1.2.3. Policy Initiatives

Measures underway / planned

- Construction of a modern passenger terminal at Limassol port with a view to increase the standard of services offered to customers. This project, partly financed by the EU, is expected to be completed by mid 2008. It will be fully compliant with Schengen, safety and new security requirements as set by the EU.
- Enlargement of the western container terminal's stacking area in the port of Limassol, with a view to facilitate container traffic. The project is expected to be completed by the end of 2007.
- Dredging of Lemesos (Limassol) port to 15 m. The project is expected to start by the end of 2005 and be completed in the first half of 2006.
- Implementation of the Larnaka project, aiming at transforming the port of Larnaka into the main passenger port of the Island. The project will be undertaken with the DBFOT method. Construction works are anticipated to start in late 2006 and the first phase to be completed in 2009.

4.1.3. Airports

4.1.3.1. Current Situation

With Nicosia airport becoming inoperative since 1974, Larnaca airport was hastily developed to serve as the Island's main airport. However, the airport was developed without a proper masterplan and as a result lacks the necessary capacity and functionality to accommodate the increasing traffic. Paphos airport was developed in 1983 to facilitate tourist development of the western part of the Island. It also faces problems of capacity but its major problem is the extreme seasonality of its traffic. Whilst periodical improvements of the facilities have offered some relief, the existing infrastructure is not considered adequate to accommodate further traffic growth in the future, as problems of congestion and delays are already a commonly observed, in the summer time, phenomenon.

4.1.3.2. Policy Priorities

The major policy priority in the area of airports is the modernization and upgrading of the airport infrastructure and the utilization of the strategic geographical location of Cyprus, which provides the potential of transforming the Island into a regional transit hub and an important link of the Trans-European Networks.

4.1.3.3. Policy Initiatives

Measures underway

- Redevelopment of the two airports in Larnaka and Paphos using the BOT method (Build, Operate, Transfer). It is expected, that in the first months of 2006, the chosen consortium will take over the management of the existing terminals and start the construction of the new airports.

The new airport infrastructure for Larnaca and Paphos is expected to be completed (only Phase 1, which provides for the development of a new passenger terminal with ancillary facilities, having a capacity of handling 7.5 mln passengers per year in Larnaca and 2.7 mln passengers in Paphos) within four and three years respectively from the time the consortium takes over, i.e. in late 2009 and late 2008 respectively.

4.2. Energy

4.2.1. Current Situation

The energy system of Cyprus is heavily dependent on oil imports for its energy supply (90%). The remaining 10% is covered by imports of coal (6%) used by the cement industry and by solar energy (4%) used for heating water in the household and tertiary sector (e.g. hotels).

Electricity production is based on petroleum products and absorbs on average 37.5% of the total energy consumption. In view of the comparatively high increase in electricity demand, there is a need for further expansion of the system. It is noted, in this respect that in the past few years, electricity demand has been rising on an average by 6.5% per year.

Apart from the very high degree of dependence on imported oil, other weaknesses, from the point of view of the infrastructure and operation of the energy system, are the limited oil storage capacity and the energy intensive models of behavior, particularly in the passenger transport sector and the limited use of renewable energy sources⁴³.

With regard to security stocks of petroleum products, their level is set by the *acquis communautaire*, according to which member states should maintain at all times, at least 90 days average daily internal consumption stocks. According to the transitional period granted to Cyprus, stocks for 60 days consumption have to be maintained as from accession to the EU till the end of 2007, whereas they have to rise to 90 days as from 1.1.2008.

4.2.2. Policy Priorities

The main policy priorities pursued by Cyprus are the following:

- Increasing the level of security stocks of petroleum products
- Diversification of the energy supply sources

4.2.3. Policy Initiatives

Measures underway / planned

Increasing the level of security stocks of petroleum products

- Signing of a bilateral agreement between Cyprus and Greece in October 2003, according to which security stocks may be maintained in Greece.
- Implementation of a programme for the relocation of the Larnaca depot through the construction of storage depots in the Vasilikos area (including the L.N.G. terminal - below). The construction of the storage depots at the Vasilikos area (including the L.N.G. terminal - below) is planned to begin in early 2007 and estimated to be completed by the end of 2009. The construction of the storage depots (including the L.N.G. terminal - below) will be financed through the Build, Operate and Transfer (B.O.T.) or the Build Operate and Own (B.O.O.) method.

Diversification of the energy supply sources

- Construction of a receiving / regasification terminal for Liquified Natural Gas (LNG), which would make possible the importation of natural gas. This project is planned to begin in 2007 and be completed by 2009.

5. Environmental Sustainability⁴⁴

5.1. Current Situation

The overall environmental situation in Cyprus is characterized by deficiencies in environmental infrastructure, particularly in the area of urban waste water treatment, solid and hazardous waste

⁴³ The promotion of renewable energy sources is covered in the section on environmental sustainability.

⁴⁴ This section corresponds to Guideline No. 11. Another part of this guideline is covered in Annex 1.

management. Moreover, a continuous degradation of the natural environment particularly in the coastal areas was observed, due mainly to tourist development, whereas in the area of the energy intensity of the economy and the green house gases emissions, the relevant indicators for Cyprus are at relatively higher levels as compared to the EU average. This is to be explained by the following factors:

- The technology used in the generation of electricity (use of heavy fuel oil);
- The operation of energy intensive industries such as cement production;
- The absence of public transport systems such as railways, simultaneously with the fact that the bus system is not well developed.

Energy consumption is steadily increasing, whereas the transport sector accounts for a significant percentage of the total energy consumption,

5.2. Policy Priorities

The main policy priorities pursued by Cyprus in the area of the environment are the following:

- The creation / expansion of the environmental infrastructure for a sustainable management of resources and waste;
- The protection, preservation and management of coastal areas;
- The promotion of energy saving and renewable energy sources;
- The reduction of greenhouse gases emissions;
- The internalization of external environmental costs.

5.3. Policy Initiatives

5.3.1. Creation / Expansion of the Environmental Infrastructure for a Sustainable Management of Resources and Waste

Measures underway / planned

A Waste Management Strategy has been adopted by the Council of Ministers in April 2004. The strategy covers all waste streams and the requisite environmental infrastructure; the tendering of a major initiative to establish packaging waste management; appropriate pricing; and awareness-raising to reduce waste production. The implementation of the Waste Management Strategy is to be completed by 2009.

5.3.1.1. Urban Wastewater Treatment

Cyprus was granted a transitional period, until 2012, to meet all requirements of the Directive 91/271/EEC, on Urban Wastewater, i.e. to serve all communities with a population of more than 2000 inhabitants, with sewerage networks and sewage treatment.

- *Rural Communities with population exceeding 2000 inhabitants.* Based on a feasibility study, the Government plans the construction of sewerage networks and sewage treatment plants to serve rural communities with a population exceeding 2000 inhabitants.

- *Expansion of sewerage networks and sewage treatment plants in all major municipalities.* The funding of these projects is covered from loans taken-up by the Sewage Boards and costs are fully recovered from levies imposed on the users.

5.3.1.2. Solid Waste

- Implementation of a Strategic Plan for the Management of Solid and Hazardous Waste. It provides for the establishment of four regional centres (one per administrative district) for waste management.

5.3.1.3. Hazardous Wastes

- Based on the results of a feasibility study, a Management Plan will be prepared in 2006, which will include the design, construction and operation of a Central Treatment Facility for Hazardous Wastes in Cyprus. The Central Treatment Facility is expected to be completed by early 2009.

5.3.1.4. Packaging Waste

- The Environment Service has called for tenders for the establishment of a system for the collection, transport, separation, recovery and recycling of packaging waste in the Districts of Nicosia and Limassol. The successful tenderer will commence implementation by the beginning of 2006.

5.3.2. Protection, Preservation and Management of Coastal Areas

It is noted that through the Town and Country Planning Law, areas of aesthetic and landscape value have been declared as Coasts and Areas for the Protection of Nature and Protected Landscapes, with very prohibitive provisions as far as development control is concerned.

Measures underway / planned

Two very important measures are underway with regard to the coastal management and sustainable development. These are the Coastal Area Management Programme (CAMP) and the Blue Flag programme:

- CAMP - A project is planned aiming at developing the methodology of Integrated Coastal Zone management as well as the application of tools for its implementation.
- Blue Flag - Cyprus has fully implemented the "Bathing Water Quality Directive". The first report regarding the quality of the bathing waters of Cyprus will be submitted to the EU before the end of the year.

5.3.3. Promotion of Energy Saving and Renewable Energy Sources

Measures underway / planned

- *Renewable Energy:* A programme, became operational as from February 2004, with a view to promote energy saving and renewable energy sources utilization; hence contributing positively to environmental sustainability. The targets of the programme are to increase the contribution

of renewable energy sources from currently 4% to 9% by 2010 and for electricity production from zero to 6% by 2010. The programme provides financial incentives in the form of grants for the encouragement of investments and/or tariff subsidisation in the fields of energy conservation and the promotion of Renewable Energy Sources (RES) utilisation. It is financed through a special Fund; its revenue accruing from a levy of 0,13 cent (CYP) / Kwh on the consumption of electricity.

- *Transport sector*: The following measures were adopted in November 2004 for the encouragement of the sustainable use of energy:
 - A significant reduction of the excise duty for small and middle class volume engine vehicles;
 - A 15% discount for the purpose of the excise duty for cars with CO₂ emissions of 150gr/km or less and, at the same time, a 10% penalty on cars with CO₂ emissions of 275gr/km or more;
 - Excise duty and registration fees on electric cars were abolished, whereas dual propulsion cars (hybrids) are now subject to half the registration and circulation fee;
 - An incentive for scrapping of vehicles older than 15 years, was introduced;
 - The discount in the form of a lower circulation licence that benefited older cars was abolished;
 - Finally, a provision was introduced for a small fee, paid for each saloon and light commercial vehicle before being cleared by the Customs (one cent per cc of engine – e.g. for a 1600cc car EURO 27 is paid). The total amount so collected is earmarked for the development and enhancement of public transport, and is considered as an innovative measure to Cyprus budgetary practice.
- Elaboration of a five year programme for the promotion of energy saving, which will be implemented as from 2006. The programme will be mainly financed from the special fund for energy conservation and the promotion of renewable resources. It includes a number of measures:
 - The undertaking of an intensive campaign on energy saving;
 - The provision of a subsidy on the excise duty of hybrid cars;
 - Promotion of the use of biofuels through the imposition of a zero excise duty on biofuels;
 - Expansion of the use of the school bus;
 - Energy saving through relevant investment expenditure in public buildings;
 - By the construction of new buildings of the broader public sector, the relevant provisions on energy saving should be complied with;
 - Public procurement – The energy performance will be introduced as a criterion in the purchases of electrical equipment and motor vehicles by the Government.

5.3.4. Reduction of Greenhouse Gases Emissions

- A Strategic Plan for a reduction on greenhouse gases emissions has been prepared, in order for the country to contribute to the global efforts to address climate change. Actions to promote the use of RES, such as installation of wind farms, of high efficiency air conditioning systems and electric appliances, energy-efficient lighting bulbs and automations, solar collectors, photovoltaic systems, promotion of co-generation and energy conservation and the campaign on public awareness on climate change, commenced since 2004. These actions are mainly financed from the special fund on renewable resources.

5.3.5. Internalization of External Environmental Costs

Measures underway / planned

- An Environmental Impact Assessment (EIA) is required for all major projects, according to the legislation in force, which is in full compliance with the relevant EU Directive.
- The principles of the polluter and user pays have been incorporated in new environmental legislation, such as in the laws for air and water pollution control and waste management.

Environmental Technology Action Plan

- Currently, a road map on the Environmental Technologies Action Plan (ETAP), is being prepared (expected to be completed by the end of the year), which will include actions for internalizing negative environmental externalities, a campaign for raising business and consumer awareness on the use of environmental technologies, e.g. energy saving, while measures to promote the dissemination of environmental technologies will be taken in the framework of the Action Plan on Green Public procurement.

Green Public Procurement

- An action plan will be elaborated by the end of 2006, with a view to promote green public procurement.

Environmentally Harmful Subsidies

- The approved subsidy schemes shall be further screened by the Environment Service, by the end of the year, in order to establish whether any of these subsidies have adverse environmental impacts. According to the findings, the necessary recommendations shall be made to the appropriate authorities, in order to establish procedures and a timetable for their possible withdrawal.

V. EMPLOYMENT CHALLENGES

A. Introduction

The Cypriot labour market is characterized by conditions of near full employment and, comparatively to other EU member states, high participation and employment rates. Indicatively, the unemployment rate, according to the Labour Force Survey was at 5% of the economically active population in 2004, being at considerably lower levels as compared to the EU average, whereas the overall participation rate amounted to 72.6% in the same year. Furthermore, the overall employment rate was at 69.1% in 2004, whereas the employment rate for women stood at 59.0%, only marginally below the 2010 Lisbon targets of 70% and 60% respectively; the employment rate for older workers was at 50.1%, exceeding marginally the relevant Lisbon 2010 target of 50%.

Another basic characteristic of the labour market is the employment of large numbers of foreign workers, particularly in unskilled or low-skilled occupations, as well as an increasing number of Turkish Cypriots. In 2004 the foreign workers represented around 14% of total gainful employment, including the employment of EU-25 nationals. Excluding EU nationals, foreign workers accounted for 12.3% of gainful employment, whereas T/Cs accounted for a further 1%.

Additional characteristics of the labour market in Cyprus are the following:

- The labour market operates in an environment with well established social dialogue;
- Quantitative imbalances between supply and demand in the labour market are observed, mainly, in the sectors of hotels and restaurants, wholesale and retail trade as well as in the sector of construction. At the occupational level, there are shortages in technical and low skilled occupations;
- Weaknesses of the educational system in responding to labour market needs in a flexible way;
- Concentration of unemployment among the youth, women and older persons;
- Low utilisation of flexible forms of employment, including part-time employment;
- Low labour participation rate of persons with special needs;
- Room for further increase of the participation rate of women in the labour market, indicating an increased need for care services for dependent persons.

B. Challenges / National Targets in relation to the European Employment Strategy (EES)

The overall objectives of the employment policies in Cyprus, in line with the EES, concentrate on enhancing the conditions of full employment, improving quality and productivity at work and strengthening social cohesion. The achievement of the above objectives requires an effective tackling of the major challenges confronting Cyprus. The main challenges faced by Cyprus are the following:

1. Maintain high rates of increase of labour supply, particularly by raising old-aged and female participation rates and reduce gender inequality;
2. Increase the flexibility of the labour market;
3. Orderly management of economic migration issues to serve the economic and social needs of the country;

4. Further development of human capital;
5. Enhance further the conditions of social cohesion.

Cyprus's national targets in relation to the European Employment Strategy have been set as follows:

1. Increase the overall employment rate to 71% by 2010
2. Increase the employment rate of women to 63% by 2010
3. Increase the employment rate of older workers to 53% by 2010

1. Maintain High Rates of Increase of Labour Supply, particularly by Raising Old-aged and Female Participation Rates, and Reduce Gender Inequality⁴⁵

1.1. Current Situation

The shortages in the labour market and the gradual ageing of the population, increase the need for attracting idle labour force (women, old aged etc.) into the labour market. Despite their relatively high participation and employment rates, as compared to other EU member states, there is still potential for their further increase and a better utilization of the idle endogenous labour force. Moreover, it is necessary to build employment pathways for young people and reduce youth unemployment, which is much higher than the national unemployment average, indicating difficulties in the transition process from education to work. Furthermore, there is a need for strengthening the employability of the unemployed.

Concerning gender equality, gender gaps in employment and unemployment and pay are still widespread in Cyprus. The problem lies primarily in the pay gap (23.8 % in 2004, compared to 25.9% in 2000). However, there has been a significant improvement over the past decade, with the gender pay gap declining significantly by over 5 percentage points. The main reason for the gender pay gap is sectoral or occupational segregation; there is a higher percentage of men with professional qualifications and managerial positions in the labour market, whilst women predominate in lower paid, low skill jobs (shop and office assistants) and part-time employment (in 2004, 13.2% of employed women held a part-time job, compared to only 5.2% of men). It is expected that the downward trend of the gender pay gap, observed over the past decade, will continue with the rising number of women professionals (especially university graduates) entering the labour market, a phenomenon already observed in recent years.

1.2. Policy Priorities

- Increase the participation of women and older persons in the labour market, as well as build employment pathways for young people and the unemployed;
- Reduce gender inequality, particularly the pay gap.

⁴⁵ It corresponds to Guideline No. 18.

1.3. Policy Initiatives

Measures underway / planned

1.3.1. Increasing Female Participation

With a view to facilitate women to reconcile work and family life and encourage the further integration of women into the labour market, there are various actions underway:

- Continuation of the Scheme for the Encouragement, Strengthening and Reinforcement of Female Entrepreneurship. This Scheme commenced operation in 2002.
- Scheme for the promotion of training and employability of economically inactive women - within the framework of the activities of the Human Resource Development Authority (HRDA). The scheme, co-financed by the ESF, will be implemented, over the period 2005–2008.
- Continuation of the Government Grants in Aid Scheme, providing, financial and technical assistance to non governmental organizations and local communities for the development of child care facilities and family support services for older persons and persons with disabilities.
- Action aiming at expansion and improvement of care services for the children, the elderly, the disabled and other dependents, co-financed from the ESF, in the current programming period under Objective 3 of the Structural Funds. The action entails the following activities:
 - Carrying out a survey, that is expected to be completed at the beginning of 2006, aiming at the identification of social care needs at the local level;
 - Development of ten programmes addressing the needs of older persons, children, persons with disabilities and other vulnerable groups, such as day care programmes.

The programmes, will commence operation in the second half of 2006. It is expected that 2.500 women will benefit from these services, which will facilitate their entry into the labour market.

- Implementation of a measure, co-financed from the ESF, in the current programming period under the Community Initiative EQUAL of the Structural Funds, aiming at the reconciliation of family and professional life by developing more flexible and effective forms of work organization and support services. The implementation of the measure started in 2005 and will be completed in 2007.
- Action aiming at the promotion of flexible forms of employment, co-financed from the ESF, in the current programming period under Objective 3 of the Structural Funds. The action is presented, in more detail, in the section concerning the flexibility of the labour market.

1.3.2. Gender Equality

With a view to strengthen the effective implementation of the equality legal framework, which is harmonized with the acquis, the Department of Labour appointed in May 2004, Gender Equality Inspectors. Further, the following measures are underway:

- Increase of the public funds allocated to NGOs and the National Machinery of Women Rights to promote and implement gender equality programmes.
- Undertaking of a comprehensive study, in 2006, with a view to identifying problems and defining possible ways, including best practices in other countries, in order to reduce the gender pay gap.

1.3.3. Active Ageing

- Continuation of the scheme promoting the self employment of elderly persons. This Scheme aims to keep persons, over 63 years old, active by providing them with incentives for re-activation and participation in social life.
- Increase of the retirement age – as from 1.7.2005, the retirement age for civil servants is being gradually increased from 60 to 63 years; the retirement age of 63 becoming fully effective as from July 2008.
- Increase of the retirement age in the broader public sector from currently 60 to 63 years. The Government plans to promote the conclusion of a similar agreement to the one reached with the civil service, with the employees of the Semi-Government Organisations as well for the teachers at primary and secondary levels of education.

1.3.4. Build Employment Pathways for Young People

- A Scheme for youth entrepreneurship providing government grants with a view to fostering youth entrepreneurship was introduced in July 2004, aiming to support activities falling within the sectors of manufacturing and e-commerce, as well as specific activities dealing with services and tourism. Additionally, this Scheme promotes the development of innovative projects, the adoption of new technologies and new products, and the support of services that enhance the quality of the tourism product.
- A Scheme for the promotion of training and employability of young secondary education school leavers, co-financed by the ESF will be implemented by the HRDA, over the period 2005–2008. This scheme aims at providing vocational training opportunities and organized practical experience to young secondary education school leavers, so as to significantly improve their potential in entering/ reentering the labour market.

1.3.5. Build Employment Pathways for the Unemployed

- A Scheme for the promotion of training and employability of the unemployed, co-financed by the ESF will be implemented by the HRDA, over the period 2005-2008. The scheme aims at providing vocational training opportunities and organized practical experience to the unemployed so as to significantly improve their potential in entering/ reentering the labour market.

2. Increase the Flexibility in the Labour Market⁴⁶

2.1. Current Situation

The labour market in Cyprus can be considered to be relatively flexible and well functioning. It is noted in this respect, that the flexibility in the labour market was further enhanced through the adjustment of the COLA system⁴⁷ as from the second half of 1999, with the exclusion of the impact of

⁴⁶ It corresponds, to a certain extent, to Guidelines No 20 and 21.

⁴⁷ The COLA system has contributed positively towards harmonious labour relations and industrial peace. It is noteworthy that in 1974, after the Turkish invasion and occupation of part of the island and the resulting huge unemployment problem, the trade unions did not simply accept a temporary suspension of the COLA system, but also a massive cut in wages and

risks in excise taxes from COLA. There is a differentiation of earnings increases across sectors, with nominal pay increases in low growth sectors being lower as compared to the national average pay increases. This development is a sign of the relative flexibility in the wage settlement system in Cyprus, notwithstanding the existence of the backward looking, though modified, COLA system and low utilisation of incentive oriented remuneration schemes. However, there is room for improvement, taking into account the observed quantitative and qualitative imbalances as reflected by mismatches between demand and supply in a number of occupations and the significant presence of foreign workers in the Cypriot labour market.

Moreover, it is noted that in 2002-2003, the legal framework was expanded with the enactment of legislation regulating part-time and fixed-term employment, thus securing conditions that are conducive towards these forms of employment. Part-timers constituted, in the second quarter of 2004, 8.7% of total employment, being however, at much lower levels as compared to the EU average. Concerning contract work, 10% are employed on fixed term contracts.

2.2. Policy Priorities

- Enhancement and modernisation of the Public Employment Services;
- Promotion of flexible forms of employment;
- Ongoing assessment of the economy's labour market needs.

2.3. Policy Initiatives

Measures underway / planned

2.3.1. Enhancement and Modernisation of the Public Employment Services (PES)

- Implementation of a measure aiming at enhancing and modernizing the Public Employment Services, over the 2005-2008 period, co-financed from the ESF, under Objective 3 of the Structural Funds. The enhancement and modernisation of the Public Employment Services is expected to contribute positively towards increasing labour market flexibility by a better matching of the demand and supply of labour and the better utilisation of the labour force.

2.3.2. Promotion of Flexible Forms of Employment

- Action aiming at the promotion of flexible forms of employment, co-financed from the ESF, in the current programming period, under Objective 3 of the Structural Funds. The action entails the following activities:
 - Undertaking of a study with a view to identifying modern and flexible forms of employment in other countries, as well recommendations for specific flexible forms of employment in the case of Cyprus.
 - Pilot implementation. It will start in July 2006.
 - Evaluation of the pilot implementation. It will take place in the first half of 2008.

salaries. The Government is confident that should serious economic problems arise in the future, the social partners would consider any necessary adjustments to the COLA system.

2.3.3. Ongoing Assessment of the Economy's Labour Market Needs

A better anticipation of skill needs, labour market shortages and bottlenecks will contribute positively towards achieving a better matching of the demand and supply of labour and the better utilisation of the labour force. Towards this end, the HRDA will conduct during the period 2005-2008 the following studies:

- Long term Employment Forecasts in the Cyprus Economy 2005-2015 (provision of employment forecasts for 44 selected economic sectors and for 27 selected occupations).
- Long term Forecasts for the Employment Prospects in Higher Level occupations in Cyprus 2005-2015 (examination of the employment prospects in 104 higher-level occupations).
- Long term Forecasts for the Employment Prospects in Middle Level occupations in Cyprus 2005-2015 (examination of the employment prospects in 90 middle-level occupations).
- Annual investigations for the identification of initial training needs, with the involvement of the Social Partners.

3. Orderly Management of Economic Migration Issues to Serve the Economic and Social Needs of the Country

3.1. Current Situation

As already indicated, a large number of foreign workers is employed in Cyprus, particularly in unskilled or low-skilled occupations. In 2004 the foreign workers represented 12.3% of total gainful employment, excluding EU-25 nationals, whereas this percentage rises to around 14% if they are also included. From a sectoral perspective, in 2004 34.9% of the foreign workers in Cyprus were employed as household help, 17.9% worked in the sector of hotels and restaurants, 9.2% in agriculture, 8.8% in manufacturing, 9.6% in trade and 10.3% in construction.

3.2. Policy Priorities

- Review of overall strategy towards the employment of foreign labour force with the aim of establishing a balanced approach to the issue by taking into consideration the inter-play of three main factors:
 - The strategic re-orientation of the economy towards higher added activities
 - The policy objective for the mobilization of the presently inactive labour force and
 - The potential labour mobility from the EU-25, and shortly EU-27, labour market.

3.3. Policy Initiatives

Measures underway / planned

- Implementation as from 2006 of the new strategy for the effective management of economic migration.

- Preparation of a new immigration law providing a comprehensive framework for immigration policy.

4. Further Development of Human Capital⁴⁸

4.1. Current Situation

The labour force constitutes the most important factor of production for the Cyprus economy and its development is therefore a high priority. Within this framework, particular importance is attached towards the continuous improvement of the quality of education and the flexibility of the educational system, at all levels, in order to secure its closer and more effective link to the labour market needs, as well as a continuous upgrading of the training / retraining programmes.

Cyprus has, generally, a comprehensive educational and training system, offering extensive opportunities for the acquisition of knowledge and skills.

4.1.1. Formal education

In recognition of the crucial role of education and training for the future course of the Cyprus economy, the Government is promoting major reforms at the upper secondary cycle of the educational system, including the technical and vocational schooling. In this context, there is a systematic effort to develop a better balance between basic areas of learning, new technological developments related to the shift towards a knowledge-based economy and the needs of the labour market.

Furthermore, the Ministry of Education and Culture is implementing a programme for introducing information technology in all levels of education.

Apart from the promotion of the above-mentioned reforms in upper secondary education, a number of initiatives are also underway to increase opportunities for university level studies in Cyprus. These include the decisions taken by the Council of Ministers for establishing a Technological University and an Open University, in order to facilitate access to learning for all citizens of any age wishing to learn.

4.1.2. Training

4.1.2.1. Initial Training

Initial out-of school training is provided through an apprenticeship scheme in operation since 1963, as well as through shorter courses organised by the Human Resource Development Authority (HRDA), which include enterprise-based initial training, accelerated training and management training of tertiary education graduates.

The apprenticeship scheme is currently under review, due to the operational and structural problems that it is facing. The most important operational and structural problems faced in recent years by the Apprenticeship Scheme are the following:

⁴⁸ It corresponds generally to Guidelines 23 and 24.

- The low educational standard of students and the lack of uniformity of the classes;
- The lack of opportunities for instructors to adopt modern teaching techniques;
- The existing infrastructure in technical schools is not sufficient to cover the needs of the enrolled students;
- Only a few companies have adequate facilities to provide on the job training;
- Its operating rules and regulations need modernisation.

4.1.2.2. Continuing Education and Training

Continuing education and training as part of a coherent system of lifelong learning is a key factor for maintaining a highly skilled and adaptable workforce and improving employability. A system of continuing education and training is well established in Cyprus. The main promoter for continuing vocational training (CVT) is the Human Resource Development Authority, which funds both private and public providers to deliver programmes according to priorities identified through research studies and surveys.

Further to the activities of the HRDA, opportunities for adult continuing education are offered through both public and private institutions.

The existence of a comprehensive educational and technical / vocational education and training system is generally evident from the following indicators:

1. The percentage of people aged 20-24 that have completed the Lyceum (upper secondary education) is 80.1%, which is higher than the EU average (75.5%), but lower than the EES target of 85% by 2010 (Statistics of Education, 2003/2004).
2. The net participation rate in education for young persons of 12-17 years old is estimated at 93% (Statistics of Education, 2003/2004).
3. Cyprus education is free up to the age of 18 and is compulsory up to the age of 15. 99.7% of the graduates of compulsory education continue their studies to upper secondary education (86% in secondary general and 14% in technical/vocational education). It is thus obvious that the participation rate in technical/vocational education is quite low, particularly for girls which comprise only 17% of the total population in the technical/vocational schools.
4. Participation in the apprenticeship scheme is low, estimated at 1.5% of the total upper secondary education population.
5. About 66% of the secondary education graduates continue their studies in tertiary education (22% in Cyprus and 44% abroad).
6. 31.9% of the labour force have higher education compared to 24.2%, which is the EU average.
7. The overall participation rate in training amounted to 9.3% for persons aged 25-64, lower than the EU average (9.9%) and considerably lower than the EES target of 12.5% by 2010.

The picture emerging is that education in Cyprus is strong on many fronts, yet there is room for improvement, especially as concerns multiple skills and adaptability, the attractiveness of technical / vocational education and the apprenticeship scheme, whereas the participation rate in training is rather low, indicative of the need for a more coherent and comprehensive lifelong learning strategy.

4.2. Policy Priorities

The main policy priorities are the following:

- The continuous improvement of the quality of education at all levels;
- Increase opportunities for university education level studies in Cyprus;
- Continuous upgrading of skills to labour market needs, in particular through reforming and making more attractive vocational education and training systems, including the apprenticeship scheme and upgrading of training and retraining programmes, via also supporting training infrastructure;
- Development of a comprehensive life-long learning strategy.

4.3. Policy Initiatives

Measures underway / planned

4.3.1. Continuous Improvement of the Quality of Education at all Levels

Introduction of Modern Technology in Education

- Implementation of an action, during the period 2005-2008, aiming at introducing modern technology in education, co-financed from the ESF, under Objective 3 of the Structural Funds.
- Implementation of an action, during the period 2005-2008, aiming at ensuring that secondary education teachers will become digitally literate and will acquire skills to implement the new, ICT oriented, curricula. The action is co-financed from the ESF, under Objective 3 of the Structural Funds,

It is noted that there are a number of other initiatives underway with a view to promoting e-learning, which are presented in the microeconomic chapter, in the section on information and communication technology – e-learning.

4.3.2. Increase Opportunities for University Studies in Cyprus

- Introduction of new departments in the University of Cyprus.
- Operation of the Open University of Cyprus, by September 2006.
- Operation of the Technological University of Cyprus, by September 2007.
- Potential for establishment of Private Universities, following the enactment of the relevant legislative framework regulating their operation in July 2005.

4.3.3. Continuous Upgrading of Skills to Labour Market Needs

4.3.3.1. Secondary Technical and Vocational Education (STVE)

- Implementation of an action aiming at strengthening the quality and attractiveness of STVE and improving the organization of STVE, co-financed from the ESF, under Objective 3 of the Structural Funds. The action will be implemented over the period 2006-2008.

4.3.3.2. Apprenticeship Scheme

- Implementation of action aiming at upgrading the apprenticeship scheme, rendering it a creditworthy, desirable and practical option for all those wishing to continue their career development via the vocational and not the educational path. The action is co-financed from the ESF, under Objective 3 of the Structural Funds. The action will be implemented over the period 2006-2008.

4.3.3.3. Upgrading of Training

- Undertaking, during the period 2005-2006, of a special study aiming at evaluating the impact of the existing HRDA's schemes on the labour market and the Cyprus economy in general.
- Extension of the rendered training programmes - As already mentioned above, the Human Resource Development Authority will promote, during the period 2005-2008, 3 co-financed by the ESF Schemes for selected target-groups, in order to facilitate their adjustment to work life and their integration in employment:
 - Promotion of training and employability of economically inactive women
 - Promotion of training and employability of the unemployed
 - Promotion of training and employability of young secondary education school leavers.

Moreover, the HRDA will promote during the period 2005-2008 consultancy services and Training to Microenterprises employing 1-4 persons, through a scheme, co-financed by the ESF.

Furthermore, in the framework of the policy priority area for adapting the education and training systems in response to new competence requirements, the Human Resource Development Authority will promote during the period 2005-2008 the following measures:

- Further support of the Training Infrastructure of Institutions and Enterprises – through appropriate enrichment of the existing scheme entitled Training Infrastructure Support Scheme (de minimis rule).
- Introduction of an Appraisal and Certification System for Training Providers with due emphasis on quality as well as the functioning and effectiveness of the system. The system will be developed in phases, commencing in 2006 and is expected to become operational in 2007.
- Introduction of a Vocational Qualifications System in two phases, over the period 2006-2013, covering a broader range of occupations in the sectors of manufacturing, the hotel industry, construction, trade/ repairs of motor vehicles as well as cross sectoral occupations, mainly the administrative ones.

4.3.4. Development of a Comprehensive Life-Long Learning Strategy

- Elaboration of a comprehensive life-long learning strategy by the end of 2006. Such a strategy should provide appropriate links between initial and continuing education and training, matched with the development of a competence-based structure of vocational qualification standards.

5. Enhance the Conditions of Social Cohesion

5.1. Current Situation

Cyprus is generally characterized by conditions of social peace and broader social cohesion. Economic inequality, poverty and social exclusion are not major problems in Cyprus. This is attributable mainly to the traditionally low unemployment rate, as unemployment constitutes the main source of poverty and exclusion. Moreover, the long-standing social policies pursued contributed positively to the maintenance of conditions of social cohesion. However, pockets of exclusion do exist amongst the elderly, people with disabilities, the single-parent families and families whose head has low educational qualifications.

In this respect the Government within the framework of its overall social policy to ensure an adequate standard of living for everyone, provides public assistance to every person legally residing in Cyprus if his/her resources do not meet his/her basic and special needs as determined by law.

Moreover, it is noted that the current legislation on Public Assistance incorporates employment incentives to encourage the integration / reintegration into the labour market of public assistance recipients and their gradual independence from public funds. For example, special categories of vulnerable persons are entitled to public assistance even if they are employed full-time.

Furthermore, there are a number of Government schemes and grants targeting vulnerable groups such as the elderly, persons with disabilities, drug users, low income households wishing to acquire their own home etc. It is also noted in this respect, that social pension is granted to persons above the age of 65, who are not eligible for pension via the Social Insurance Scheme.

The emphasis attached by the Government of Cyprus in enhancing the conditions of social cohesion and modernizing the social protection system is reflected in an improvement of the situation concerning social inclusion and income distribution intertemporally, as shown indicatively by a comparison of the results of the Family Budget Survey carried out in 2003 vis a vis the corresponding results of the Family Budget Survey of 1996/1997. More specifically,

- The percentage of people at risk of poverty (having an income lower than 60% of the equivalent median income) fell from 16.3% of the total population, in 1996/97 to 15.3% in 2003, and it is now equal to the EU-25 average for 2001.
- The risk of poverty for older persons (over 65), who represent 11.9% (2003) of the total population, among whom the risk of poverty is mainly concentrated, fell from 58% to 52%.
- Similarly, there was a 10 percentage-point decrease in the risk of poverty among persons living in one-person households (65+ years old). As the most vulnerable group of the population, these persons still have the highest probability of being below the poverty line, although the relevant figure fell from 83% in 1997 to 73% in 2003.
- The rate of childhood poverty, which according to the 1997 statistics was one of the lowest in the EU, decreased by 1 percentage point reaching 11% in 2003.

- The inequality of income distribution fell as evidenced by the S80/S20 indicator, which decreased to 4.1 in 2003 as compared to 4.4 in 1997. Similarly, the Gini coefficient fell below the EU average to 0.27, showing a long-term downward trend in income inequalities.

5.2. Policy Priorities

The Government of Cyprus attaches great importance towards enhancing the conditions of social cohesion. The main policy priorities are the following:

- Ensuring an adequate standard of living for disadvantaged and vulnerable groups and encouraging their integration / reintegration into the labour market;
- Safeguarding affordable access to government services, including education and health to all.

5.3. Policy Initiatives

5.3.1. Ensuring an Adequate Standard of Living for Disadvantaged and Vulnerable Groups and Encouraging their Integration / Reintegration into the Labour Market

Measures underway / planned

5.3.1.1. Horizontal Measures

- Implementation of a measure aiming at facilitating access and return to the labour market for those who have difficulty in being integrated or reintegrated, co-financed from the ESF, in the current programming period, under the Community Initiative EQUAL of the Structural Funds. The measure, which started in 2005 and will be completed in 2007, entails, inter alia, the following activities:
 - Promotion of approaches that combine guidance, training, placement as well as individualised services and usage of all information systems and development of the skills of target groups;
 - Improvement of the skills of members of these groups by providing mentoring and support, in order to ensure the active participation of the target groups at all stages of implementation;
 - Development of the skills of a significant number of unemployed who are discriminated, in particular, to specialisations in the social sector of the economy and activities concerning the commercial use of the internet and new technologies of communications.

5.3.1.2. Public Assistance Recipients

- Review of the current legislation on Public Assistance. The main proposed amendments are the following:
 - Introduction of additional employment incentives aiming at the reduction of benefit dependency (e.g. continuation of the public assistance for a period of one year after a beneficiary enters employment, thus increasing the total income while employed, without losing the eligibility for social assistance);
 - Increase of certain benefits and expansion of eligibility criteria.

The amended legislation is expected to come into force at the beginning of 2006.

- Implementation of a Scheme for the activation of public assistance recipients and promotion of equal opportunities for their integration into the labour market. This Scheme, co-financed from the ESF, within the framework of Objective 3 of the Structural Funds, aims at the occupational rehabilitation of public assistance recipients and will include vocational training programmes and appropriate incentives to employers by subsidising (40%) their wages for a period of 12 consecutive months. 400 recipients of public assistance (240 men and 160 women) are expected to benefit from training courses under this Action and about 65% of the recipients, who will successfully complete training, are expected to be integrated in the labour market.

5.3.1.3. Persons with Disabilities

- Implementation, over the 2006-2007 period, of a training scheme for the disabled, co-financed from the ESF, within the framework of Objective 3 of the Structural Funds.
- Implementation, over the 2006-2007 period, of a scheme providing incentives for the employment of people with disabilities, co-financed from the ESF, within the framework of Objective 3 of the Structural Funds.

5.3.1.4. Older Persons

- Elaboration and implementation of a 10 year Action Plan for the development of health care services for the elderly, setting short, medium- and long- term targets.
- Implementation of the National Action Plan for Older Persons. The Action Plan is expected to begin being implemented in 2006. The main pillars of the plan include:
 - A system of Social Protection to secure decent living standards for older persons.
 - Productive occupation of older persons;
 - Securing an accessible and supportive environment through the provision of home and institutional care services for the elderly and persons with disabilities, day care and tele-care services, family support grants, vacation support and housing grants;
 - Access to knowledge, education and lifelong learning;
 - Healthcare provision.

5.3.1.5. Children and Families at Risk of Poverty

- Elaboration in 2006 and implementation of an Action Plan for Children 2005-2010, which will incorporate policies, objectives and an implementation strategy for the exercise of children's rights. It is based on the principles enshrined in the UN Convention on the Rights of the Child.

5.3.1.6. Drug Users

- Implementation of the National Drug Strategy and the Action Plan for Drug Demand Reduction (2004–2008) aiming to achieve an integrated and comprehensive drug policy through interventions in the fields of education, family, health, employment, research, communication, treatment and social integration.

5.3.1.7. Asylum Seekers

- Implementation of a measure, co-financed from the ESF, in the current programming period under the Community Initiative EQUAL of the Structural Funds, aiming at the promotion of supporting interventions for asylum seekers until the final assessment of their application. In addition, the measure is aiming at the enhancement of the skills of the asylum seekers in order to be better qualified to access the labour market in Cyprus or to be better equipped for their

integration in their home country if their application is rejected. The implementation of the measure started in 2005 and will be completed in 2007.

5.3.1.8. Access to Housing

- Continuation of the various housing schemes aiming to assist low-income families and refugees to acquire their own home.

5.3.2. Safeguarding Affordable Access to Government Services, including Education and Health to all

As far as education is concerned, education in Cyprus is free up to the age of 18 years and it is compulsory up to the age of 15. Furthermore, it is noted that there are no tuition fees for studies at the university of Cyprus, whereas an annual student grant of £1000 (in cases of the non existence of fees) and £1500 (in cases of fees) is provided to all persons studying in tertiary educational level institutions in Cyprus or abroad.

In the area of health, there is free medical care in public hospitals to a very vast percentage of the whole population. Eligible for free medical care are all civil servants as well as a single living person with an annual income of lower than £9.000, a family of two with an income lower than £18.000; for families with children, this income threshold is further increased by £1.000 per dependent child. Eligible for reduced rates are a single living person with an annual income between £9.000 and £12.000, a family of two with an income between £18.000 and £22.000; for families with children, this income threshold is further increased by £1.000 per dependent child.

Free medical care in public hospitals is also provided to persons with chronic and serious diseases, such as AIDS infected persons.

It is noteworthy that the policy initiatives underway to reform the secondary technical and vocational educational system, including the apprenticeship scheme, as well as the introduction of the General Health Scheme will considerably improve the access of the lower income groups to education and health.

Moreover, the initiatives underway to enhance the provision of web-enabled services by the public sector as well as the gradual development of one-stop-shops in the civil service, presented in the microeconomic chapter, will facilitate access to government services to all.

ANNEXES

ANNEX 1: SUPPLEMENTARY INFORMATION

1. Guideline No. 11: To encourage the sustainable use of resources and strengthen the synergies between environmental protection and growth

1.1. Policy Priority 1: Energy efficiency and co-generation

The largest part of this policy priority is covered in the main text on environmental sustainability, under Section 5.3.3. “The promotion of energy saving and renewable energy sources”.

1.1.1. Environmentally friendly eco-efficient technologies

1.1.1.1. Current Situation

Cyprus does not have the capacity to carry out basic research and relies, almost entirely, on applications of imported technology. Therefore, Cyprus concentrates more on the diffusion of eco-innovations and eco-efficient products rather than their development.

1.1.1.2. Policy Initiatives

Measures underway / planned

A number of existing schemes may be utilised in introducing eco-efficient and environmentally friendly technologies. These include the following:

- Scheme for the establishment of new enterprises of high technology and innovation through business incubators;
- Scheme for the technological upgrading of manufacturing industries;
- Grant Scheme for environmental protection investments to combat industrial pollution.

1.2. Policy Priority 2: To promote the development of means of internalisation of external environmental costs and decoupling of economic growth from environmental degradations

This policy priority is covered in the main text on environmental sustainability, under Section 5.3.5.

1.3. Policy Priority 3: Continue to fight against climate change, while implementing the Kyoto targets in a cost-effective way, particularly in regard to SMEs

Part of this policy priority is covered in the main text on environmental sustainability, under the challenge of reducing greenhouse gases emissions (Section 5.3.4.).

1.3.1. Current Situation

The Mediterranean is among the regions vulnerable to climate change and thus the issue is of particular priority to Cyprus. Cyprus is a party to the Climate Change Convention and has ratified the Kyoto Protocol.

Cyprus has no quantified greenhouse gases emissions reduction commitments, as it is not included in Annex I of the Convention on Climate Change and Annex B of the Kyoto Protocol, and was not an EU member state when the burden - sharing agreement was reached, for the first period (2008–2012). Agreeing on such commitments is an issue to be settled after negotiations with the European Commission.

Another challenge is the high rate of per capita emissions of greenhouse gases, owing, inter alia, to the climate of the country, high rate of economic growth, etc.

1.3.2. Policy Initiatives

Reference is made, in the main text on environmental sustainability, to the Strategic Plan for reducing greenhouse gases emissions.

Cyprus adopted a national law on Emissions Trading in 2004. A National Allocation Plan for carbon dioxide emissions was completed in 2004.

Measures taken towards the reduction of carbon dioxide emissions fall under Sections 5.3.3. and 5.3.4. of the main text on environmental sustainability: “The promotion of energy saving and renewable energy sources” and “The reduction of greenhouse gases emissions”.

1.4. Policy Priority 4: Pursue the objective of halting the loss of biological diversity between now and 2010

1.4.1. Current Situation

Cyprus is an island with natural richness, soil and climate particularities, isolation but also proximity to 3 continents, and being located in one of the major world bird migration routes. The Cyprus landscape is also characterized by extremes of variety and diversity.

Conflicting and competitive demands for space and pressure on scarce land resources, are also taking their toll on habitats and species. The accumulation of stress factors in the coastal zone is considerable, and it is necessary to forestall these trends with adequate means.

1.4.2. Policy Initiatives

1.4.2.1. Policy Framework

Nature protection has been subject to legislation and measures since the early 1960s. Over the past few years, particular emphasis was placed in identifying and mapping habitats of European significance.

The BIOCYPRUS database includes detailed description of protected habitats and species of community importance. A Gene Bank and Herbariums are maintained. A systematic inventory of the population and spatial distribution of rare and endemic plant species is being carried out and a data bank has been established.

The introduction of genetically modified organisms is regulated by Law which transposed the relevant Directive 2001/18/EC. Generally, Cyprus has a restrictive policy for such releases.

1.4.2.2. Measures underway / planned

The protection, preservation, and management of coastal areas is covered in the main text on environmental sustainability, under Section 5.3.2.: “The protection, preservation and management of coastal areas”.

Furthermore, the following measure is underway to halt the loss of biodiversity

- Preparation of management plans for 13 sites included in the NATURA 2000 Network.

2. Guideline No. 12: To extend and deepen the Internal Market

2.1. Policy Priority Area 1: Speed up the transposition of Internal Market Directives

2.1.1. Current situation

Cyprus has proceeded to a rapid transposition of the remaining internal market directives, reducing the deficit to 1.7% of the total number of the internal market directives, according to the latest scoreboard of July 2005. The EU-25 deficit was 1.9% whereas the EU-15 deficit was even higher 2.1%.

2.1.2. Policy Initiatives

Measures underway / planned

- Continuous monitoring of the transposition of the remaining internal market directives, so that Cyprus will achieve a reduction of its transposition gap to 1.5% by the end of 2005 and to maintain this good record thereafter.

2.2. Policy Priority Area 2: Give priority to stricter and better enforcement of Internal Market Legislation

2.2.1. Current Situation

Particular emphasis is attached to the effective enforcement of the Internal Market legislation.

2.2.2. Policy Initiatives

Measures underway / planned

- Continuous monitoring of the effective enforcement of Internal Market legislation and corrective action if considered necessary.

2.3. Policy Priority Area 3: Eliminate remaining obstacles to cross-border activity

2.3.1. Current Situation

The trade liberalisation process was generally completed before accession, whereas the few remaining obstacles covering mostly trade of agricultural products were eliminated at the latest by 1.5.2004 i.e. upon accession. Moreover, the necessary technical harmonisation in the various product groups has been effected.

The more specific situation is as follows:

Technical barriers

In the harmonized areas, with a view to facilitate trade and assist production to conform with specific product requirements, Cyprus adopted all harmonised European standards as national standards, hence reducing substantially the potential barriers to trade.

In the non-harmonised areas, the mutual recognition clause is applied on all EEA products, as from 1.5.2004.

Parallel imports

Cyprus has adopted and implements the relevant *acquis* on parallel imports.

Market surveillance

A market surveillance system is operational in Cyprus with good, established cooperation with the National Customs Authority.

Cross border investments

Concerning cross border investments, the Cyprus Authorities have adopted a gradual approach to their liberalisation, which was completed on May 1st 2004, the date of Cyprus's accession to the EU.

Noteworthy is also the abolition of all restrictions on foreign direct and portfolio investment by residents of third countries, except in the cases provided differently in sector specific legislation, as from 1.10.2004.

Services

All restrictive provisions based on nationality that were in place in the exercise of a number of professions, as well as restrictions that applied to the acquisition of real estate by EU natural and legal

persons and the right of establishment and operation of businesses were set aside, as from the date of Cyprus's accession to the EU, so as to safeguard the right of establishment and the free provision of services.

As far as mutual recognition of professional qualifications is concerned, Cyprus has transposed through relevant new legislation the *acquis* with regard to the relevant three General System Directives 89/48/EEC, 92/51/EEC and 99/42/EC.

2.4. Policy Priority Area 4: Apply EU public procurement rules effectively

2.4.1. Current Situation

The legislative framework, currently in force, in the area of public procurement (classical and utilities sectors) is in full compliance with the older EU Directives. However, the need arises for compliance with the new European Union Directives 2004/17/EC, coordinating the procurement procedures of entities operating in the water, energy, transport and postal services sectors and 2004/18/EC on the coordination of procedures for the award of public works contracts, public supply contracts and public service contracts. The Public Procurement Directorate of the Treasury of the Republic has prepared an action plan for the effective transposition of these Directives into national legislation and for increasing the openness of public procurement.

2.4.2. Policy Initiatives

Measures underway / planned

- Introduction in 2006 of new legislation on public procurement implementing the new EU Directives 2004/17/EC and 2004/18/EC.
- Enhancement of the administrative capacity of the Public Procurement Directorate (PPD) of the Treasury and of all the contracting authorities. This measure will entail the preparation of a detailed "Best Practice Procurement Guide" and is expected to be completed in early 2007.
- Implementation of e-procurement in Cyprus. The measure has started in 2005 and full implementation is expected by the end of 2008.

2.5. Policy Priority Area 5: Promote a fully operational internal market of services, while preserving the European social model

2.5.1. Current Situation

In the area of a fully operational internal market of services, Cyprus participates in the various discussions taking place at EU level for the liberalization of the services sectors.

2.5.2. Policy Initiatives

Measures underway / planned

- Establishment of a Single Point of Contact, by the end of 2008, to facilitate service providers from other Member States to complete at one point all the necessary procedures and formalities needed for establishing and operating subsidiaries.

2.6. Policy Priority Area 6: Accelerate financial market integration by a consistent and coherent implementation and enforcement of the Financial Services Action Plan

2.6.1. Current Situation

2.6.1.1. FSAP Policies

Cyprus's transposition rate of FSAP Directives reached on the 10th of July 2005 nearly 70%, while for another 20% of the FSAP Directives the notification has been sent to the European Commission and the examination is under way.

The remaining of the FSAP Directives, whose adoption by Cyprus is still pending, will be transposed by Cyprus and notified to the Commission not later than the transposition dates referred to in the Directives. These Directives are the following:

- Directive on the prudential supervision of pension funds (2003/41/EC)
- Directive on Take Over Bids (2004/25/EC)
- Directive on Markets in Financial Instruments (2004/39/EC)⁴⁹
- Transparency Directive (2004/109/EC)⁵⁰.

2.6.1.2. Other (supplementary) FSAP-related Policies

The institutional framework for the Cyprus Stock Exchange (CSE) has been significantly modified to enable the CSE to be in line with EU legislation and to confront the new competitive environment of the European single market successfully.

As regards the achievement of a fully operational internal market of services in the EU, Cyprus promotes the following measures:

- Cyprus, in line with EU directives, takes all necessary supplementary measures for combating any kind of money laundering and / or terrorist financing activities through the financial system.
- Cyprus supports the notion of “better regulation” at the EU level, in an effort to minimize unnecessary costs and assess the impact of new regulations.
- Cyprus has supported and adopted the Memorandum of Understanding (MoU) for the Management of Financial Crises at the EU level. In the same area, Cyprus has been considering the introduction of all necessary administrative arrangements, at the national level, in order to facilitate the implementation of the provisions of the EU MoU mentioned above (2006).
- As regards the financial sub-sector for government bonds, Cyprus is considering the introduction of trading mechanisms and market practices similar to those utilized in the euro-area so that the further integration of the domestic market with the EMU market will be facilitated. In the same area, Cyprus has immediately adopted the EU Collective Action Clauses (CACs) for the issuance of government bonds in the international market (adopted in 2004).

⁴⁹ FSAP - Lamfalussy Directive.

⁵⁰ FSAP - Lamfalussy Directive.

- Cyprus also participates actively in the follow-up and monitoring EU committees for the convergence of the Clearing and Settlement mechanisms in the EU and for the abolition of the remaining barriers to cross-border transactions.

2.6.2. Policy Initiatives

2.6.2.1. FSAP Measures

Measures taken

On the 9th of September 2005, two FSAP Directives (the Prospectus Directive and the Market Abuse Directive) and three Commission Directives have been transposed into national Law. These Directives are the following:

- Directive on insider dealing and market manipulation (2003/6/EC);⁵¹
- Commission Directive (2003/124/EC)¹ implementing Directive 2003/6/EC, as regards the definition and public disclosure of inside information and the definition of market manipulation;
- Commission Directive 2003/125/EC¹ implementing Directive 2003/6/EC as regards the fair presentation of investment recommendations and the disclosure of conflicts of interest;
- Commission Directive 2004/72/EC¹ implementing Directive 2003/6/EC as regards accepted market practices, the definition of inside information in relation to derivatives on commodities, the drawing up of list of insiders, the notification managers' transactions and the notification of suspicious transactions;
- Directive on prospectuses (2003/71/EC).¹

Measures underway / planned

- Adoption of legislation for the transposition of the remaining FSAP Directives:
 - Directive on the prudential supervision of pension funds (2003/41/EC). It is expected to be enacted in 2006.
 - Directive on Take Over Bids (2004/25/EC). Cyprus will transpose the Directive by May 2006, which is the transposition date.
 - Directive on Markets in financial Instruments (2004/39/EC). Cyprus will transpose the Directive by 30th October 2006, which is the transposition date.
 - Transparency Directive (2004/109/EC). Cyprus will transpose the Directive by the 20th of January 2007, which is the transposition date.

⁵¹ FSAP - Lamfalussy Directive.

2.6.2.2. Supplementary FSAP-related Measures

Measures underway / planned

- Introduction of a widely acceptable primary dealers' mechanism and of an electronic trading platform in the domestic market for government bonds (2006).

3. Guideline No. 15: To promote a more entrepreneurial culture and create a supportive environment for SMEs

3.1. Overall Situation

Cyprus is characterized by a generally favourable to business administrative and institutional framework. Indicatively, the administrative framework, procedures for entry and exit of firms in the market are relatively simple; the procedure for registering a new firm with the Registrar of Companies and Official Receiver takes only around 7 working days, but the period is reduced to 4 days or even less, if the applicant opts for the accelerated procedure, by paying an immaterial fee. Regarding the exit of companies from the market, this is accommodated by quite simple insolvency and liquidation procedures.

Furthermore, there is a generally favourable tax regime. It is noted in this respect, that Cyprus introduced a broader tax reform in 2003, leading to a more simplified and efficient system. In the field of direct taxation, there was a reduction of marginal tax rates and a broadening of the tax base, as well as compliance with the EU Code of Conduct of Business Taxation. In the area of indirect taxation, there was a harmonisation of the tax base and the adoption of the minimum levels of excise and VAT rates prescribed by the acquis.

Through the broader tax reform, there is a shift of the tax burden from direct to indirect taxation, while the reduction of the tax burden on capital and labour is expected to positively contribute towards the creation of a more favourable business climate and on the incentive to work.

The above factors contribute positively to the strengthening of an already highly developed entrepreneurial culture as is evident by the relatively large number of enterprises operating in Cyprus and the significant number of new enterprises created each year, the overwhelming majority of which are SMEs.

It is noted that 99.9% of the enterprises operating in Cyprus are classified as Small and Medium Sized Enterprises, according to the European Union definition. SMEs have been a dynamic source of employment growth and value added generation.

However, there are a number of weaknesses faced by SMEs in Cyprus. The most important are the following:

- The small size of the domestic market;
- The small size of the enterprises (4,4 persons on average per unit in 2000 according to the Registration of Establishments carried out in that year), which hinders the exploitation of economies of scale and the adoption of advanced technologies and modern methods of management, production design and marketing;
- The family character of the vast majority of SMEs;
- Relative difficulties in the access to financing.

3.2. Policy Priority Area 1: Improve access to finance

3.2.1. Current Situation

Despite the fact that the situation regarding access to financing through credit institutions for SMEs is relatively satisfactory and has been improving over the past few years, following the liberalization of interest rates and capital movements, SMEs still face problems in finding the necessary collateral requested by banks, taking also into account the weak structures of SMEs and the relatively high mortality rate that is observed.

It is noted that as far as micro-lending is concerned, for loans up to €25.000 banks do not require collateral. Collaterals are necessary for loans exceeding this threshold.

3.2.2. Policy Initiatives

Measures underway / planned

The government in its effort to facilitate SMEs access to finance and foster a more entrepreneurial culture, to encourage more people to create their own business as well as facilitating the consolidation of small enterprises, has introduced and will continue the operation of the following schemes⁵²:

- Business Incubators – programme for the creation of new, high technology enterprises through the operation of business incubators;
- Scheme for enhancing women's entrepreneurship;
- Scheme to foster youth entrepreneurship;
- Establishing a Loan Guarantee Granting Facility. The guarantee facility, that will be offered, will facilitate financing of viable projects which otherwise could not be implemented, due to the lack of collateral. It will be gradually introduced as from 2007.
 - Programme for the relocation of small enterprises to authorized areas.
- Establishing a Loan Guarantee Granting Facility. The guarantee facility, that will be offered, will facilitate financing of viable projects which otherwise could not be implemented, due to the lack of collateral. It will be gradually introduced as from 2007.

⁵² It is noted that a scheme provides for a government guarantee for loans granted to SMEs in the manufacturing sector, whereas the other schemes provide generally for grants, under specific conditions set in the scheme. The schemes addressed to the manufacturing sector are not included here, as they are in another section of the Programme.

3.3. Policy Priority Area 2: Strengthening economic incentives including by simplifying tax systems and reducing non wage labour costs

3.3.1. Current Situation

As already said, Cyprus introduced a broader tax reform in 2003, leading to a more simplified and efficient system, with lower marginal tax rates for both legal entities and physical persons. Through the broader tax reform, a uniform corporation tax rate of 10% was introduced, implying a reduction of the corporation tax rate for local companies from its previous levels of 20% and 25%, depending on the level of profits, and an increase of corporate taxation for the international business sector from 4,25% to the current 10%. In the case of physical persons, there was a substantial increase in the non taxable income from around €10.200 to around €17.000, and a lowering of the highest marginal tax rate from 40% to 30%.

As far as non-wage labour costs are concerned, the social insurance contributions are at much lower levels compared to the EU average. Specifically, currently, the social insurance contributions for employees are at 16,6% of earnings, subject to a monthly earnings ceiling, whereby 6,3% is paid by the employer, 6,3% by the employee and 4% by the state. For the self-employed, the social insurance contribution rate amounts to 15,6%; individuals pay 11,6% and the state contributes 4%.

In brief, there is little scope for any measures in this area.

3.4. Policy Priority Area 3: Strengthen the innovative potential of SMEs

3.4.1. Current Situation

The potential of SMEs for research and innovation activities is relatively limited. The various policy initiatives underway or planned with a view to enhance the research and innovative potential of SMEs is presented in the relevant sections to increase and improve investment in R&D and to facilitate all forms of innovation in the main text.

3.5. Policy Priority Area 4: Provide relevant support services to SMEs

3.5.1. Current Situation

A one stop shop, the Investors Service Centre, was set up in December 1999 and operates under the auspices of the Ministry of Commerce, Industry and Tourism. The one-stop shop has the following functions:

- Provision of information to investors regarding financial, legal and taxation matters in implementing a project in Cyprus;
- Provision of advice to potential investors regarding the most effective way of making use of the package of the various benefits offered (e.g. Grant Schemes);

- Liaising with various governmental departments and facilitating the process of granting the necessary approvals, such as the work permits, required for implementing a project;
- Provision of aftercare service aimed at anchoring existing investors and encouraging them to upgrade their activities in Cyprus.

The one-stop shop plays a vital role in attracting Foreign Direct Investment (FDI) in targeted industries, such as the development of high technology products and technology transfer, both essential for the upgrading and the enhancement of the competitiveness of the production base of the economy.

3.5.2. Policy Initiatives

Measures underway / planned

- An amendment to the Bankruptcy Law, has been prepared and is under the legal vetting process, with a view to modernize to a large extent the current Bankruptcy Law. It is expected to become law within 2005.

4. Guideline No. 18: Promote a lifecycle approach to work

The first four policy priorities of the Guideline are covered in the section on maintaining high rates of increase of labour supply in the employment chapter, whereas the last one is covered in the macroeconomic chapter.

5. Guideline No. 19: Ensure inclusive labour markets, enhance work attractiveness, and make work pay for job-seekers, including disadvantaged people, and the inactive

5.1. Policy Priority 1: Active and preventive labour market measures

5.1.1. Current Situation

There are a number of active and preventive labour market measures underway. The enhancement and modernization of the Public Employment Services and the ongoing assessment of the economy's labour market needs is covered in the section on increasing the flexibility in the labour market, whereas the section on maintaining high rates of increase of labour supply includes the new schemes introduced by the HRDA targeted to inactive women, youth and the unemployed.

5.2. Policy Priority 2: Continual review of the incentives and disincentives resulting from the tax and benefit systems

5.2.1. Current Situation

Within the framework of the broader tax reform fully implemented as from 2004, there was a substantial increase of the income of physical persons taxed with a zero rate from £6.000 to £9.000 for the year 2003 and to £10.000 as from 1.1.2004. In addition, there was a considerable reduction of the maximum tax rate for individuals from 40% to 30% for chargeable income exceeding £15.000 for the year 2003, and £20.000 as from 1.1.2004. Moreover, there was an abolition of the Defence Levy, a

special contribution for the defence of the Republic, on the contribution paid by the employee, 2% on earnings, as from 1.7.2002. The above changes imply a significant reduction of the tax burden on the factor of production labour, with positive effects on the incentives to work.

Concerning the unemployment benefit, its limited duration to 6 months, hinders it from being a disincentive for work.

Concerning public assistance, the increasing number of persons receiving public assistance is a reason for concern. However, as stated elsewhere in the chapter on employment, the relevant legislation will be amended, with a view to enhancing the incentives for work for public assistance recipients.

5.3. Policy Priority 3: Development of new sources of jobs in services to individuals and businesses, notably at local level

The issue is covered in the macroeconomic chapter of the Programme, especially the section on the promotion of the diversification of the economy.

6. Guideline No. 20: Improve matching of labour market needs

The first and the third policy priorities of the Guideline are covered in the section on increasing the flexibility of the labour market, whereas concerning the fourth one, there is a separate section in the employment chapter for the appropriate management of economic migration.

6.1. Policy Priority: Removing obstacles to mobility for workers across Europe within the framework of the Treaties

Cyprus is actively participating in the EURES network involving advertising job vacancies across the EU, and this is expected to help raise labour market flexibility and mobility and contribute positively to better match labour market needs.

7. Guideline No. 21: Promote flexibility combined with employment security and reduce labour market segmentation, having due regard to the role of the social partners

7.1. Policy Priority 1: Adaptation of employment legislation, reviewing where necessary the different contractual and working time arrangements

This policy priority is covered in the section on increasing the flexibility of the labour market.

7.2. Policy Priority 2: Addressing the issue of undeclared work

7.2.1. Current Situation

There is no reliable estimation on the magnitude of undeclared work. It is noted in this respect, that the recent broader tax reform has reduced the incentives for underreporting of income and earnings. However, such an underreporting takes place in the case of the self employed, whereas the presence of illegal foreign workers constitutes another source of undeclared work.

7.2.2. Policy Initiatives

Measures underway / planned

- A bill is pending for approval before the House of Representatives, aiming at reducing tax evasion by self employed. The main provisions include: submission of returns of income by persons earning more than the income taxed with a zero rate, keeping of books and accounts and submission of audited accounts by self-employed with annual turnover of over £25.000, compulsory issue of invoices and receipts by self employed and companies, introduction of self-assessment for self-employed, and replacement of the penalty for late submission of returns (currently 5% on tax) with a fixed sum of £30 and additional penalty of 10% on tax.

7.3. Policy Priority 3: Better anticipation and positive management of change

7.3.1. Current Situation

This issue is mainly covered in the macroeconomic chapter in the section on the promotion of the further diversification of the economy, whereas the continuous improvement of the quality of education and the upgrading of the training and retraining schemes to labour market needs is covered in the section on the further development of human capital in the employment chapter.

7.4. Policy Priority 4: Promotion and dissemination of innovative and adaptable forms of work organisation

The issue of promoting flexible forms of employment is covered in the section on increasing the flexibility in the labour market in the employment chapter.

7.5. Policy Priority 5: Support for transitions in occupational status

The issue is covered in the sections on increasing the flexibility of the labour market and the further development of human capital in the employment chapter.

8. Guideline No. 22: Ensure employment-friendly labour cost developments and wage-setting mechanisms

8.1. Policy Priority 1: Encouraging social partners within their own areas of responsibility to set the right framework for wage bargaining

8.1.1. Current Situation

Collective bargaining is by far the most representative method for the employers and workers to agree the terms and conditions of employment, including wages. Collective agreements are, normally, of two or three year duration. The system has been operating effectively for nearly 30 years and enjoys a high level of support on the part of the social partners, as it has succeeded in securing industrial peace. Wage increases do not appear to have had a major impact on inflation. Trade unions, generally, limit

wage demands to the level of yearly national productivity. Furthermore, over the past few years, collective agreements have been agreed upon with relatively low wage increases, especially in sectors that are experiencing problems.

The issue of reducing the pay gap is tackled in the section on maintaining high rates of increase of labour supply in the employment chapter.

8.1.2. Policy Initiatives

Measures underway / planned

- Wage increases were frozen in the public and semi-government sector for the years 2004 and 2005, whereas a 2% and 1% increase are planned for the years 2006 and 2007 respectively.
- Continuous exercise of moral suasion by the Government on the social partners to exhibit moderation within the framework of the collective agreements and agree to wage increases that are in line with productivity gains.

8.2. Policy Priority 2: Reviewing the impact on employment of non-wage labour costs

The issue is dealt with in Annex 1, in the section on Guideline 15.

9. Guideline No. 23: Expand and improve investment in human capital

The first and the third policy priorities of the Guideline are covered in the section on the further enhancement of human capital in the employment chapter.

9.1. Policy Priority: Significantly reducing the number of early school leavers

9.1.1. Current Situation

In 2004, the ratio of early school leavers (people aged 18-24 who have left school with only lower-secondary education) was 18.4% (14.3% females and 23.3% males), which is higher than the EU average ratio of 15.9% and the EES target of 10% by 2010. It must be noted, however, that the above mentioned ratio of 18.4% does not correspond to the actual percentage of early school leavers in Cyprus, which, according to data kept by the Ministry of Education and Culture, is estimated at 13%. This considerable difference is due to the fact that the Cypriot students abroad (about 29.1% of the Cyprus population between the ages of 18-24, in the school-years 2003-4 and 2004-5) are not included in the sample of the survey used by the Statistical Service, while temporary foreign workers of low education are included.

9.1.2. Policy Initiatives

Measures underway / planned

The reform of the secondary technical vocational educational system underway and the planned reform of the apprenticeship scheme will contribute positively towards reducing significantly the number of early school leavers. These measures are presented in the section on the further enhancement of human capital in the employment chapter.

10. Guideline No. 24: Adapt education and training systems in response to new competence requirements

The policy priorities of this Guideline are covered in the section on the further enhancement of human capital in the employment chapter.

ANNEX 2: THE USE OF THE EU COHESION AND STRUCTURAL FUNDS IN SUPPORT OF THE LISBON OBJECTIVES

1. The Current Programming Period 2004 - 2006

The funds allocated to Cyprus, via the EU Cohesion Policy, for the current programming period, 2004 - 2006 are utilized through the following programming documents:

- Single Programming Document (SPD) for Objective 2;
- Single Programming Document (SPD) for Objective 3;
- Single Programming Document (SPD) for Fisheries;
- Strategy Paper for the Cohesion Fund;
- Rural Development Plan.

In order to ensure the consistency and coherence of the programming documents, the National Development Plan 2004–6 covering the whole spectrum of Cyprus development needs, was prepared beforehand. The National Development Plan is a strategic plan presenting the vision of the government, consisting of five development priorities, namely (i) extension and upgrading of infrastructure, (ii) improvement of competitiveness, (iii) human resource development and equal opportunities, (iv) balanced regional and rural development and (v) protection of environment and improvement of quality of life. The National Development Plan covers all measures/projects that are programmed for the period 2004-6 and safeguards, by incorporating also the areas to be co-financed by the EU, the coherence of the development policy of the government for that period.

The programmes to be co-financed in the context of Cohesion Policy will be implemented in the period 2004–2008 and they will contribute to the achievement of a number of the priorities of the Lisbon Action Programme in a complementary way. More specifically, they are targeted towards achieving objectives relating to the following guidelines of the Lisbon Action Plan: “Guideline 10: To strengthen the competitive advantages of its industrial base”, “Guideline 15: To promote a more entrepreneurial culture and create a supportive environment for SMEs”, “Guideline 16: To expand, improve and link up European infrastructure and complete priority cross-border projects” as well as the Employment Guidelines.

Below, details are given of the objectives of each programme and the measures through which these will be achieved.

1.1. Objective 2 Programme

The Single Programming Document for Objective 2 covers two geographically distinct sub-areas: a) a wide rural area and b) an urban area along the cease–fire line. In both areas the depopulation effect is obvious. According to the 2001 Census of Population, the Objective 2 areas show a much lower population increase compared to the whole of the country (6.6% for the rural areas and –2.8% for the urban Objective 2 areas for the period 1982–2001 compared to 18.2% for the whole of Cyprus). In the rural areas, the depopulation effect has also led to the ageing of population. Furthermore, especially in the mountainous regions there is a lack of community facilities, which creates barriers to access to opportunities.

The overall aim of the Objective 2 Programme is the economic and social regeneration of urban and rural areas in order to achieve greater social and economic cohesion. The total financial resources of the Objective 2 Programme amount to €58.69 mln out of which €28.02 mln will be co-financed from the EU.

The strategy of the Programme will be implemented through three Priorities:

The first priority on rural areas is implemented through 3 measures:

- *Measure 1.1: Strengthening of the Economy of Rural Areas.* The measure includes the provision of grant schemes to private businesses, in the areas of rural tourism and manufacturing SMEs.
- *Measure 1.2: Business Support Infrastructure.* The measure deals with the provision of public-led business support infrastructure, which will facilitate the diversification of the economic base in the rural areas. This Measure aims to enrich the rural tourism product and the development of general business support infrastructure.
- *Measure 1.3: Developing thriving local communities.* The measure aims to create an attractive built environment both for the visitors but also for the local population.

The second priority, on urban development, is implemented through one Measure:

- *Measure 2.1: Integrated Urban Development,* which attempts to create more competitive locations for the establishment of new enterprises in the urban area and to improve the attractiveness for the visitors, employees and inhabitants along the cease-fire line.

The Programme as described above promotes the objectives of the Lisbon strategy that are included under “Guideline 10: To strengthen the competitive advantages of its industrial base” and “Guideline 15: To promote a more entrepreneurial culture and create a supportive environment for SMEs”.

1.2. Objective 3 Programme

The Single Programming Document (SPD) for Objective 3, which is co-funded by the European Social Fund (ESF), aims at the development and more efficient utilization of human capital in conditions of social cohesion and equal opportunities, through the promotion of employment and the qualitative upgrading of human capital. The total financial resources of the Objective 3 Programme amount to €43.89 mln out of which €21.945 mln will be co-financed from the ESF.

The interventions for the achievement of the main strategic objective and the general objectives of this Programme are falling under the following Priority Pillars⁵³:

- Priority Pillar 1: Development and Promotion of active labour market policies

The First Priority Pillar includes measures aiming at the promotion of employment and vocational education and training, mainly through the enhancement and modernization of the Public Employment Services, the formulation and implementation of training activities and of actions for the promotion of employment. The Pillar includes also measures for the promotion of equality of opportunities for all

⁵³ The main measures / actions are presented in more detail in the employment chapter.

with regard to access to the labour market, primarily for women and for those who are threatened with social exclusion.

- Priority Pillar 2: Promotion and improvement of education and training systems and life-long learning

The Second Priority Pillar includes measures aiming at the qualitative improvement of the rendered education and training, mainly through the utilization of new technologies and the application of modern technology to teaching methods, the development of new pedagogical approaches to teaching, the training of teachers with an emphasis on information technologies, as well as the support of the modernization of the Apprenticeship Scheme. The interventions of this Programme are in line with the Employment Guidelines of the Lisbon Strategy on growth and employment and are directed towards the objectives of full employment, job quality, labour productivity and social cohesion and inclusion.

1.3. Fisheries Programme

The global objectives of the Fisheries Single Programming Document (SPD) are:

- The achievement of a competitive and sustainable commercial fishing industry;
- The capability to offer the consumers with high quality products and meet the market demands;
- The success in meeting the European and international competition.

During the programming period 2004-2006, it is estimated that the financial allocation for the SPD will be €13.1 mln. The Programme is implemented through three Priority Axes as follows:

- Priority Axis 1: Adjustment of fishing effort;
- Priority Axis 2: Fleet renewal and modernization;
- Priority Axis 3: Protection and development of aquatic resources, aquaculture, fishing port facilities, processing and marketing and inland fishing.

1.4. Cohesion Fund

Two projects will be co-financed by the Cohesion Fund, one in the transport sector and one in the environment sector. Specifically, the projects to be co-financed are (a) the upgrading of two Limassol roundabouts to fly overs and (b) the construction of a new sanitary landfill site and transfer stations for the municipal solid waste of Larnaca and Ammochostos areas. The transport project promotes the objectives of “Guideline 16: to expand, improve and link up European infrastructure and complete priority cross-border projects”.

1.5 Rural Development Plan

A Rural Development Plan, covering the period 2004-2006, within the framework of the Structural Funds of the EU, was prepared and agreed with the European Commission, and it is currently been implemented. The Rural Development Plan has set three basic strategic objectives:

- The improvement of the competitiveness of the agricultural sector and of agricultural products;
- The restructuring of the social and economic web of the rural areas;
- The protection of the environment and the sustainable use of natural resources.

The above strategic objectives will be achieved through four priority pillars:

- Improvement of the competitiveness and modernisation of the production and distribution of agricultural products. Particular emphasis is attached to the introduction of new technology, the rational management of waste water and other agro-industrial waste materials, the restructuring of agricultural production, the development of distribution structures and the production of high value added manufacturing products of agricultural origin. Within the framework of this pillar, the existing restructuring programmes have been carefully re-examined and adapted so as to fully comply with the objectives of the structural actions of the EU.
- Protection of the environment and strengthening of the socio-economic web. The pillar includes measures aiming at the protection of the environment and the utilisation of the multi-disciplinary role of agriculture for the development of rural areas and the promotion of the traditional environmental and cultural heritage of the rural communities. It provides for substantial financial support in adopting the EU standards; the use of environmentally friendly methods of agricultural production such as biological farming; the production of aromatic plants; manufacturing and handicraft activities related to tradition, as well as the forestation of private agricultural land and the adoption of the good agricultural practice in farming activity.
- Protection, development and sustainable management of forests. The pillar includes measures for the protection of forests against fire, reforestation of burnt areas, forestation of non-agricultural state land and the development of private forestry, as well as the collection, manufacturing and marketing of forestry products.
- Technical assistance and evaluation of the programme. This pillar includes the measures required for the evaluation and support of the implementation of the programme.

The total financial resources of the Rural Development Plan amount to €158.3 mln, of which €74.8 mln will be co-financed from the EU.

2. New Programming Period 2007-2013

Cyprus is currently preparing for the new programming period, 2007–2013. More specifically the “Outline of the Development Policy”, 2007-2013 has been prepared and approved by the Council of Ministers. The Outline contains the development vision for the period, the global objectives and the development axes through which the objectives will be achieved. More specifically, it consists of seven development axes as follows:

- *Axis 1: Promotion of competitiveness;*
- *Axis 2: Enhancement of social cohesion;*
- *Axis 3: Upgrading and protection of the environment;*
- *Axis 4: Improvement of the quality of life;*
- *Axis 5: Improvement of accessibility: extension and upgrading of basic infrastructure;*
- *Axis 6: Development of human resources;*
- *Axis 7: Balanced regional and rural development.*

Following its approval, the Outline has been sent to the relevant partners (i.e. government and semi-government organisations, the economic and social partners, other interested parties) for comments and recommendations. The formulation of both the National Strategic Reference Framework and the related Operational Programmes will take into account the vision and strategy contained in the

“Outline of the Development Policy” and will be complimentary to the Lisbon strategy so that the objectives set, are in line with the Guidelines of the Lisbon Strategy. This is facilitated by the fact that the Community Strategic Guidelines for Cohesion Policy for the programming period 2007–2013, incorporate to a good extent the Lisbon priorities and also represent the development needs of Cyprus. It is noted in this respect, that the axes of Cyprus’s Outline of the Development Policy coincide with the primary challenges faced by Cyprus, as identified in the Lisbon Programme. The National Strategic Reference Framework and the Operational Programmes will be prepared in accordance with the guidelines. Programming will take place in such a way that the programming documents prepared for the Cohesion Policy, the Lisbon strategy and the national priorities are prepared in coordination and in full complementarity with each other.