



The challenge of enlargement

Commission opinion on the application by the Republic of Cyprus for membership



Supplements 1993

- 1/93 Address by Jacques Delors, President of the Commission, to the European Parliament on the occasion of the investiture debate of the new Commission
- The Commission's work programme for 1993-94
- The Commission's legislative programme for 1993
- Joint declaration on the 1993 legislative programme
- 2/93 The challenge of enlargement — Commission opinion on Norway's application for membership
- 3/93 The future development of the common transport policy
- 4/93 The challenge of enlargement — Commission opinion on Malta's application for membership
- 5/93 *The challenge of enlargement — Commission opinion on the application by the Republic of Cyprus for membership*

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Commission opinion
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the Republic of Cyprus
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Contents

Foreword	5
Introduction	7
Part One	11
Outline of the <i>de facto</i> situation in Cyprus	11
Prospects for a settlement of the Cyprus question and integration with the Community	12
Current state of relations between Cyprus and the European Community	13
Economic aspects of Cyprus's transition towards integration with the Community	14
Cyprus's participation in Community institutions	16
Conclusions	16
Part Two — Specific aspects	19
Agriculture and fisheries	19
Internal market and industrial affairs	20
Customs and indirect taxation	22
Employment, working conditions and social affairs	23
Competition	24
Financial institutions, company law and direct taxation	25
Energy	27
Environment	27
Telecommunications	27
Transport	28
Enterprise policy and tourism	28
Consumer policy	29
Implications for the Community budget	29
Cooperation in the fields of justice and home affairs	30
Regional policy	31
Statistics	31
Statistical annex — Main economic indicators	32

Foreword

1. On 3 July 1990, the Government of the Republic of Cyprus submitted to the Council of the European Communities an application for membership of the European Coal and Steel Community (ECSC), the European Economic Community (EEC) and the European Atomic Energy Community (EAEC).
2. At its meeting on 17 September 1990, the Council noted the application and decided to set in motion the procedures laid down in Articles 98 of the ECSC Treaty, 237 of the EEC Treaty and 205 of the EAEC (Euratom) Treaty, asking the Commission to draw up an opinion, as required by these provisions.
3. Applications have also been received recently from several EFTA countries and from Malta, and an application was previously submitted by Turkey. The Commission delivered its opinion on Turkey's application in December 1989, followed by opinions on the applications of Austria (August 1991), Sweden (July 1992), Finland (November 1992) and Norway (March 1993). It is transmitting its opinion on the application submitted by Malta simultaneously with this document.
4. The European Council concluded its discussion of the question of enlargement at its Lisbon meeting on 26 and 27 June 1992 with the following observations relating to the EFTA countries:

'The European Council considers that the EEA Agreement has paved the way for opening enlargement negotiations with a view to an early conclusion with EFTA countries seeking membership of the European Union ... The official negotiations will be opened immediately after the Treaty on European Union is ratified and agreement has been achieved on the Delors II package.'

In the light of the decisions taken by the European Council at its Edinburgh meeting on 11 and 12 December 1992, enlargement negotiations got under way in February 1993 with Austria, Finland and Sweden, and in April 1993 with Norway.

As regards applications from other countries, the Lisbon conclusions continue as follows:

'... The European Council considers that if the challenges of a European Union composed of a larger number of Member States are to be met successfully, parallel progress is needed as regards the internal development of the Union and in preparation for membership of other countries.

In this context the European Council discussed the applications which have been submitted by Turkey, Cyprus and Malta. The European Council agrees that each of these applications must be considered on its merits.

Relations with Cyprus and Malta will be developed and strengthened by building on the Association Agreements and their application for membership and by developing the political dialogue.'

5. The European Council which met in Copenhagen on 21 and 22 June 1993 'considered that its guidelines with regard to enlargement with the EFTA countries shall be without prejudice to the situation of other countries which have applied to join the Union. The Union will consider each of these membership applications on its own merits.

The European Council welcomed the Commission's intention to present shortly its opinions on Malta and on Cyprus. These opinions will be examined rapidly by the council taking into consideration the particular situation of each of the two countries'.

Introduction

6. Since the island was declared independent in 1960, the 'Cyprus question' has constantly been before the United Nations and has never left the agenda of the Security Council.

The existence of the Greek and Turkish communities side by side, but differing in language, culture, religion and national traditions, conferred on the young republic a turbulent history, littered with crises and outbreaks of intercommunal violence, culminating in 1974 in a coup inspired by the supporters of integration with Greece. This resulted in a military intervention by Turkey. The outcome of the crisis of August 1974 and the occupation of part of the territory of Cyprus by the Turkish army was the *de facto* partition of the island, which led to large-scale population movements across the cease-fire line and, more especially, from the northern to the southern part of the island.

This *de facto* separation of the two communities, Turkish in the north and Greek in the south, remains to this day. With very rare exceptions neither people nor goods nor services can cross the dividing line. In 1983 the northern part of the island declared itself an independent republic. With the solitary exception of Turkey, no member of the international community has recognized this republic. Until recent years the diplomatic efforts conducted under United Nations auspices to bring about a mutually acceptable institutional solution had been blocked by the intransigence of both sides.

7. In 1992 it seemed at first that the intercommunal negotiations arranged through the good offices of the United Nations Secretary-General might provide the means of gradually hammering out a solution based on a two-community and two-zone federation. The principles of this solution were approved unanimously by the Security Council in April 1992 (Resolution 774/92). The intercommunal discussions that took place in October and November 1992 revealed, however, that a great many points of disagreement remained, including on general principles and institutional aspects of the future federation. The discussions were resumed in the spring of 1993 and although it is hoped that they may lead to a final agreement, the possibility of continuing disagreements can still not be ruled out.

8. When presenting its application for accession, the Government of the Republic of Cyprus, recognized by the European Community and its Member States as the only legitimate government representing the Cypriot people, addressed the Community on behalf of the whole of the island. The application was strongly challenged by the *de facto* authorities of the northern part of the island. While acknowledging that it would be in the interests of the Turkish Cypriot community to form part of the European Community, these authorities rejected the right of the Government of the Republic of Cyprus to speak for the whole of Cyprus in such an approach. They based their position on the Guarantee Treaty and the wording of the 1960 Constitution, which grants the President and Vice-President (a Turkish Cypriot) a veto over any foreign policy decision,

particularly any decision on joining an international organization or alliance that does not count both Greece and Turkey among its members. They consider, accordingly, that in the prevailing circumstances the Community should not take any action on the application.

The Community, however, following the logic of its established position, which is consistent with that of the United Nations where the legitimacy of the Government of the Republic of Cyprus and non-recognition of the 'Turkish Republic of Northern Cyprus' are concerned, felt that the application was admissible and initiated the procedures laid down by the Treaties in order to examine it.

9. The Community has therefore to establish its position on whether Cyprus is eligible for membership, its capacity to adopt within a reasonable timescale the *acquis communautaire*, in particular the rules concerning the single market and the common policies, in order to become a dynamic member of the economic and monetary union and participate actively in the common foreign and security policy.

This opinion deals with all these factors and for the most part confirms — at least with regard to the southern part of the island — the Commission's assessment in its report of 24 June 1992,¹ namely that 'adoption of the *acquis communautaire* would not appear to present insurmountable problems in the case of Cyprus'. This assessment covers both how democracy is organized and how it operates in Cyprus — confirmed as satisfactory in the last presidential elections — and also the structure of its economy and its regulatory framework.

10. As a result of the *de facto* division of the island into two strictly separated parts, however, the fundamental freedoms laid down by the Treaty, and in particular freedom of movement of goods, people, services and capital, right of establishment and the universally recognized political, economic, social and cultural rights could not today be exercised over the entirety of the island's territory. These freedoms and rights would have to be guaranteed as part of a comprehensive settlement restoring constitutional arrangements covering the whole of the Republic of Cyprus.

11. In examining the eligibility of Cyprus for membership and its capacity to be a fully participating member of the Community and the European Union, the Community must therefore also have the greatest regard for the special links binding one of the Cypriot communities to one of the Member States, and the links between the other Cypriot community and a country which is associated with the Community — and also an applicant for accession — and one which is of major strategic, political and economic importance to the Community.

12. In drawing up this opinion, the Commission relied on information on the situation in Cyprus provided by missions visiting the island or by the authorities of the Republic of Cyprus, with which it has maintained close contact, notably through the Mission of the Republic of Cyprus to the Communities.

¹ 'Europe and the challenge of enlargement', Brussels, 24 June 1992 (Supplement 3/92 — Bull. EC).

In keeping with their challenge to the application for accession lodged by the Government of the Republic of Cyprus, the Turkish Cypriot authorities declined to cooperate with the Commission in the technical preparation of this opinion. Data on the northern part of the island were therefore obtained from the Government of the Republic of Cyprus or from available international sources. They might, therefore, have to be supplemented at a later stage. The Commission is of the view, however, that the range of information in its possession is such as to enable it to back up the analyses and conclusions of this opinion.

Part One

Outline of the *de facto* situation in Cyprus

13. Cyprus is an island strategically located in the north-eastern Mediterranean with a population of approximately 700 000 occupying an area of 9 251 km², i.e. a relatively low density (76 inhabitants/km²) and, at about 1% per year, low population growth. There is a high degree of urbanization, with rates of literacy and school enrolment and even secondary and higher education, in the southern part of the island at least, which are comparable to levels in the most advanced countries.

A population of some 570 000 lives in the south of the island, which is controlled by the Government of the Republic of Cyprus. In addition to the 130 000 Turkish Cypriots living in the north, there is also a Turkish military force (some 30 000 strong according to United Nations' estimates) and a large number of Turkish settlers (between 45 000 and 50 000 according to the same source) who have moved in since the 1974 military intervention. It should be mentioned that part of the Turkish Cypriot population that was present on the island in 1974 has since emigrated, notably to Western Europe. The northern part of the island as currently divided represents 37% of the total area.

14. The island's economic development since its *de facto* division has followed very different courses. The south has experienced remarkable economic growth, based largely on service industries and especially tourism, giving a GDP per capita of about ECU 9 000 on average for 1991, i.e. higher than in several Community Member States. Development in the north, which is more agriculture-oriented, has not been so fast. As a result of the north's diplomatic isolation, its potential and infrastructure for tourism have not been fully exploited. The contribution of agriculture to employment, added-value and foreign trade continues to be very significant in this part of the island. The GDP per capita is three or four times smaller than in the south.

15. Politics in Cyprus has also followed different courses since 1974. The Republic of Cyprus, whose authority extends in practice only to the south of the island, has retained the Constitution of 1960

although, of course, all provisions relating to the participation of the Turkish community in the exercise of executive, legislative and judicial powers are no longer applied. Indeed, some have not been applied since the intercommunal crisis of 1963.

Cyprus has a presidential-type constitution and a parliament with a single chamber. The current President, Mr Clerides, was elected for five years in February 1993 with the support of two parties forming a majority in the chamber.

There is a wide consensus in parliament behind Cyprus's application for Community membership and the long-standing, liberal-influenced economic policy which has been followed for several years and has been maintained by the government of Mr Clerides.

16. The government in the north, which is not recognized by the international community, adopted a Constitution by referendum in 1975. The Constitution was later modified in 1985.

Mr Denktash was elected President under this Constitution and re-elected in 1985 and 1990. He holds a large majority in parliament owing mainly to the Turkish settler vote. Mounting opposition is being voiced by some sections of public opinion to Mr Denktash's stance both on economic issues and on the settlement of the Cyprus question.

17. On the subject of respect for democracy and human rights, two points must be taken into account, namely that the island's forced partition alone represents a serious infringement of the fundamental freedoms of citizens of Cyprus and that the rights of victims of the events of 1974 have not yet been restored owing to the lack of a political settlement. The presence of a considerable number of Turkish settlers and the demographic changes that result from this are also considered as an infringement of the political and economic rights of the people, including by some sectors of Turkish Cypriot public opinion.

Apart from the direct and indirect consequences of the partition of the island, the human rights situation is as follows. The Constitution of Cyprus protects the rights of people belonging to the three national minorities and establishes freedom of speech and the

right to free assembly, equality of all before the law and bans all forms of discrimination. The independence of the judiciary is guaranteed. All these provisions are effectively respected. However, in the north of the island, opposition parties have mentioned certain constraints and restrictions in their activities, in particular as regards access to the media.

18. Another aspect of the political tension in Cyprus comes in the shape of the extensive military presence and excessive presence of weapons.

In addition to the estimated force of some 30 000 Turkish troops, there is a permanently mobilized Turkish Cypriot force in the north of Cyprus of an estimated 4 000. A further 26 000 form the reserve force. In the south, Greece maintains a force of just under 1 000 alongside the Greek Cypriot national guard consisting of 10 400 men plus a reserve force of 100 000.

Weapons on the island are becoming increasingly sophisticated, to the point where the defence effort maintained by each party is eating deeper into national budgets.

The United Nations force UNFICYP (1 513 strong in March 1993), which was dispatched in the wake of the civil war in 1964, still occupies the cease-fire line. After much hard debating, the United Nations recently adopted a decision which changes the way this force is financed and its structure and is to reconsider its mandate in December 1993.

Mention should also be made, finally, of the two military bases in southern Cyprus maintained by the United Kingdom under British sovereignty.

Prospects for a settlement of the Cyprus question and integration with the Community

19. The need for close cooperation between the two communities to achieve the integration of Cyprus with the European Community is highlighted in the 'set of ideas on a comprehensive framework agreement on Cyprus'. This document, unanimously endorsed by the Security Council under Resolution 774/92, formed the basis for intercommunal negotiations carried out by the Secretary-General of the United Nations during 1992. It proposes a settlement

based on a Cypriot State with a single sovereignty, international personality and citizenship, with guaranteed territorial independence and integrity and including two politically equal communities in a bi-zonal, bi-communal federation.

However, as it stands, the text was not accepted by the representatives of the two communities. Amongst issues which still remain to be settled, as can be seen clearly from the report presented by the United Nations Secretary-General at the conclusion of the talks in October-November 1992, is the fact that the Turkish Cypriot side wants a solution to the Constitution question which is more 'confederal' than the solution suggested by the 'set of ideas'. President Clerides, on the other hand, while accepting the set of ideas, has expressed the will, since his election, to introduce amendments, notably so as to reinforce references to human rights, make improvements on the operational side of the executive branch and make it more compatible with future membership of the Community.

As a result, the final balance of the settlement, especially on the institutional issues, is still the subject of talks between the parties concerned.

20. As a measure of support for the efforts of the Secretary-General, the Security Council has called on all parties to continue striving for a political settlement. More recently, the emphasis seems to have shifted towards implementation of practical measures aimed at building confidence between the two communities. Agreement on these measures could make clear the willingness of both parties to advance to an overall settlement.

21. It is of the utmost importance that the process started by the United Nations Secretary-General leads to an equitable solution which deals fairly with the interests of each community. It is equally important that, whatever the institutional balance decided in the final settlement, the process results in the establishment of institutions which are capable of carrying out their responsibilities both effectively and efficiently.

In this context, care should therefore be taken with a view of the possibility of Community membership to ensure that the decision-making process of the executive and legislature is compatible with the Community's discussion and decision-making apparatus and will enable the Cypriot authorities to adopt the *acquis communautaire* and implement it effectively throughout the island.

22. In relation to the Common Foreign and Security Policy, the need to promote a political settlement is all the more paramount as the current situation would make it difficult for Cyprus to accept and implement commitments made under the Treaty on European Union. The political problems linked to the status quo would inevitably have an impact on the Community's policies, especially those concerning Turkey. Cyprus must also give up its membership of the Non-aligned Movement of which it was a founder-member and in which it continues to participate actively.

Relations between Cyprus and the European Community

The Association Agreement

23. Cyprus has been linked to the European Community since 1973 by an Association Agreement which provides for the establishment of a customs union in two stages. This Agreement excludes discrimination between Cypriot or Community nationals and contains arrangements on trade and on financial and technical cooperation which are to be applied for the benefit of the entire population of the island.

The first stage provided for the phased reduction of tariffs on industrial goods and agricultural products. This stage was due to expire in June 1977 but was extended to the end of 1987, the deadline by which all the aims were achieved.

The Protocol governing the transition to the second stage of the Agreement, i.e. the completion of the customs union, likewise in two phases, entered into force on 1 January 1988.

The first phase, from 1988 to 1997, provides for:

(i) the reduction by Cyprus of customs duties and quantitative restrictions on industrial products (except for petroleum products and 15 categories of sensitive products) and on the 43 agricultural products covered by the Agreement;

(ii) the adoption of the Common Customs Tariff by Cyprus;

(iii) the harmonization of accompanying policies: competition, State aids, approximation of laws.

The second phase, from 1997 to 2002, provides for the free and unrestricted movement of industrial and agricultural products and the adoption of the accompanying policies required for completion of the customs union, including, in principle, the abolition of the origin rules applicable to manufactured products.

Current trade arrangements

24. The customs union agreement covers 82% of all trade between Cyprus and the Community. The current situation is as follows:

(i) the Community has entirely eliminated the final remaining restrictions on imports into the Community of industrial products originating in Cyprus, including textile products, clothing and processed agricultural products not falling under Annex II to the EEC Treaty;

(ii) by 1 January 1993, the Republic of Cyprus had already reduced duties by 64.25% by comparison with the rates applied to the Community in 1973. However, the dismantling of tariffs in the north of the island has not kept pace with the timetable fixed in the Association Agreement and Community exports attract duty at rates which are usually far higher than those applied in the south.

Adapting to the *acquis communautaire*

25. A large number of the instruments required for the progressive adaptation of the Cypriot economy to the mechanisms of the single market established by the Community and to the implications of the common commercial policy are already contained therefore in the Association Agreement and the 1988 Protocol.

The Commission considers that continuing with the proper implementation of the abovementioned instruments in accordance with the agreed timetable is the best means of ensuring a smooth passage for the Cypriot economy towards possible accession.

26. On the subject of the adoption of the *acquis communautaire*, Article 27 of the 1988 Protocol guarantees that certain principles laid down in the EEC

Treaty are applicable in relations between the two parties to the Association, e.g. competition rules, provisions on tax and approximation of laws. It is also stipulated that the measures relating to the application of these principles which are essential to ensure the smooth functioning of the customs union shall be agreed by common accord by the beginning of the second phase at the latest, which should normally mean by 1998. If this deadline is to be met, the Cypriot Government and the Commission must work in close collaboration to ensure that the two parties can honour the commitments made and that Cyprus can adapt its legislation in full knowledge of the facts.

Financial and technical cooperation

27. Financial aid from the Community to Cyprus began with the First Financial Protocol on 1 January 1979. From that date, up to and including the Third Financial Protocol, which is currently in force, the Community has granted Cyprus a total of ECU 136 million in the form of European Investment Bank loans (ECU 92 million), grants (ECU 29 million) and special loans or risk capital (ECU 15 million). The projects financed mainly concern infrastructure (urban development, drainage, electricity) and have benefited the entire population of the island. These projects have mostly been concentrated in the area of Nicosia.

Economic aspects of Cyprus's transition towards integration with the Community

28. Study of the economic situation of Cyprus confirms the view that not only would its accession to the Community create no insurmountable difficulties but, on the contrary, as long as it was carefully planned and backed up by the appropriate policies, would bring about greater prosperity and, in particular, would help the north make up the economic ground on the south.

29. In the introduction to this opinion, reference was made to the island's political division and how

this went hand in hand with different levels of economic development.

This differentiation is reflected equally in structures of production, in the extent of openness to the outside world and of international specialization, in monetary policy and, in the long run, in economic performance in terms of income, full employment, inflation and foreign trade.

30. The southern part of the island is more geared towards industry and services — mainly international tourism — though its comparative advantages in agriculture are also worth mentioning. Industry accounts for three-quarters of exports of goods. The large trade deficit is more or less compensated by the earnings from tourism. More than half of all trade is with the Community.

31. Economic growth is strong, averaging 6% over the last decade and, on account of a lack of manpower, the Republic of Cyprus resorts to labour from Eastern Europe and, lately, has even agreed to allow workers from the north to cross the border for the day. Despite overheating of the economy and full employment, inflation has been pegged to a level of 6%. These good performances have been greatly aided by adherence to a long-term policy of stabilization of the Cypriot pound against the currencies of its trading partners and, more recently, the ecu.

32. Despite this record, accession to the Community will require determined efforts from the State and the business sector. The economy continues to be overdependent on tourism, which implies a risk, in the long term, of an excessive drain on limited natural resources (e.g. water) and infrastructure and represents a factor of considerable uncertainty for the economy in a politically sensitive region, as the Gulf crisis demonstrated.

It is vital, therefore, to diversify services and to consolidate industrial development, especially as analysis of industrial structures reveals a considerable degree of vulnerability to the required level of exposure to international competition. Despite the steps taken so far towards approximation to the Common Customs Tariff, most sectors of industry still hide behind high tariffs. Duty in excess of 50% is not uncommon, even in trade with the Community, where there is also local production. Many sectors suffer from a lack of innovation and the quality of their products is vastly inferior to equivalent Community goods. Until now, foreign investment, one source of technological advance, has received little encouragement and is subjected to severe restrictions.

Maintaining the competitiveness of industry is thus still too closely linked to external protection and especially to aid in a variety of forms: guarantees, tax exemptions, investment or export finance subsidies from the State.

33. Progress towards Community membership would involve completing the dismantling of tariff protection, reducing aid and giving foreign investors greater freedom. The restructuring that such a policy requires, and which is already one of the economic goals of the present government, will be made easier by the situation of full employment in Cyprus.

34. Changes would also be necessary in the banking and financial system. Although payments relating to current transactions with the outside world are relatively unrestricted, capital movements are strictly regulated. Liberalizing capital movements will require a fundamental reform of the financial and monetary system and of procedures for credit and currency regulation.

With the exception of interest rates, which are fixed by law at 9%, this regulation of the markets is carried out solely on a quantitative basis. The introduction of market mechanisms in the system, i.e. use of the interest rate and greater competition in the banking sector, would help improve economic performance by reducing the activities of speculators — for example, investment in the property market — and at the same time increasing the range of instruments for macroeconomic regulation available to the authorities, which at the moment consist only of exchange-rate management and budgetary policy.

35. The isolation of the northern part of the island has weighed heavily on its development policies and economic performance. The economy in the north is closely linked to the economy of Turkey, from where it receives a substantial amount of budgetary support and which provides 40% of its imports, as well as being the second export market after the Community. The absence of international air links, except to Turkey, has not allowed the north to take full advantage of international tourism, despite possessing the initial potential in the way of infrastructure. Tourist arrivals, including three-quarters of Turkish nationality, generate only a quarter of the earnings from tourism in the south. Agriculture, in which the north has considerable potential, provides a quarter of employment and 10% of added-value. Industry provides about 10% of employment and contributes some 11.5% of GDP. Public service workers form a high percentage of total employment and State-owned enterprises play a significant role in economic activity.

36. The Turkish lira is the currency used in transactions. There was a proposal to introduce the north's own currency, but it never came to fruition. The Cypriot pound is in parallel circulation. Inflation is high at about 60% in 1991; the public sector finance deficit is substantial and is only partially covered by the budgetary aid from Ankara. Borrowing is thus standard practice. To improve this situation would require a considerable effort and would present the future federal government and the heads of the future Turkish Cypriot federal State with the delicate task of deciding on the allocation of tax resources.

37. Thus, in the northern part of Cyprus, the main economic issue, whether in relation to the settlement of the Cyprus question or with a view to Community membership, is how to make up the ground lost to the south.

The potential in terms of agricultural and tourist resources and manpower exists, as does the basic infrastructure required to launch the economy, but a large productivity gap has opened with the south as a result of the north's isolation and undercapitalization, which is in turn linked to uncertainty about the political future of this part of Cyprus.

If Cyprus were to join the Community, resources could be allocated to the improvement of infrastructure. A political settlement would also re-establish the complementarities between the two parts of the island. Likewise, the restoration of international links and the full opening-up of Community markets would boost local and foreign investment. Taking into account the orders of magnitude involved for a region of 130 000 inhabitants, there is no doubt that the north could make up the ground on the south or at the very least enjoy a substantial improvement of its economic performance and income as a result of a successful accession to the Community and a satisfactory political settlement. In this respect, in addition to the transitional problem of the reduction of the public sector financial imbalances referred to above, mention should also be made of the difficulty of choosing a common currency and of the need, at the least in a first phase, to maintain wage differentials between the two parts of the island.

38. The adoption of the *acquis communautaire* in relation to macroeconomic, industrial and trade policy will therefore present the southern and the northern parts of Cyprus with several problems, although none of these appears to be insurmountable in the context of an overall settlement of the Cyprus question.

In the south, as was shown in points 23 to 26 above of this opinion, the instruments to carry out the transition and the political will to use them are already available. The Community, which has already given technical assistance for the introduction of VAT and for other measures related to the transposition of the *acquis communautaire*, is prepared, if the government so wishes, to step up its technical cooperation.

In the north, the prospect of a settlement is an indispensable requirement to break the isolation to which this part of the island has been subjected and which prevents all contact and all preparation for accession. However, it is evident that considerably more effort will be required to adjust to the *acquis communautaire* than in the south. Nevertheless, the Commission is convinced that, when the time is ripe and with close cooperation from the authorities of the Turkish Cypriot community, this effort can succeed as part of the necessary economic transition of this part of Cyprus.

Participation in Community institutions

39. In points 19 to 22 above of this opinion, the Commission raised the issue of Cyprus's active participation in the Community's institutions in the context of the prospects for a political settlement of the Cyprus question.

Aside from this key issue, the Commission observed in its report 'Europe and the challenge of enlargement' that the question of participation by Malta and Cyprus in the Community institutions would have to be resolved in an appropriate manner in the accession negotiations. The Commission envisaged addressing 'this question in its opinions on these countries' applications'.

In the same report the Commission expressed some initial thoughts (in points 23 to 26) on the various institutional questions which will have to be addressed and resolved if the institutions of an enlarged union are to operate smoothly and efficiently.

40. In the case of Cyprus, one question is the introduction of an additional language, Turkish, which is one of the two official languages of the Republic of Cyprus.

41. There would also appear to be the practical difficulties involved for a State of Cyprus's characteristics in coping with the full range of responsibilities and obligations entailed in the day-to-day running of the Community's institutions.

The Republic of Cyprus has senior public officials with experience. As there is not sufficient information available and in view of the north's long isolation, the Commission is unable to draw a similar conclusion in respect of that part of the island. In short, the Turkish-Cypriot community may have difficulty in finding appropriately qualified persons amongst its own people and, as a result, problems concerning the respective representation of the two communities in Community bodies could well occur.

42. Another question that has to be asked in the light of the above is whether Cyprus would, in the foreseeable future, be able to take on the wide range of responsibilities and obligations entailed by the Presidency of the Council.

43. The institutional problems that would be posed by the possible accession of Cyprus or any other applicant of similar size should be examined as part of a more general assessment of the institutions of an enlarged European Union that has a vocation for even further enlargement.

The intergovernmental conference scheduled for 1996 should address these issues with a view to streamlining the operational structures of an enlarged Community and improving the efficiency of its decision-making procedures, while at the same time ensuring that each new Member State — regardless of its size — including possibly Cyprus, is able to take part in an appropriate manner in the discussion and adoption of decisions and to assume its responsibilities as a member.

Conclusions

44. Cyprus's geographical position, the deep-lying bonds which, for two thousand years, have located the island at the very fount of European culture and civilization, the intensity of the European influence apparent in the values shared by the people of Cyprus and in the conduct of the cultural, political, economic and social life of its citizens, the wealth of its contacts of every kind with the Community, all these confer on Cyprus, beyond all doubt, its Euro-

pean identity and character and confirm its vocation to belong to the Community.

45. A political settlement of the Cyprus question would serve only to reinforce this vocation and strengthen the ties which link Cyprus to Europe. At the same time, a settlement would open the way to the full restoration of human rights and fundamental freedoms throughout the island and encourage the development of pluralist democracy.

46. The Commission is convinced that the result of Cyprus's accession to the Community would be increased security and prosperity and that it would help bring the two communities on the island closer together. If there were to be a political settlement, the prospect of the progressive re-establishment of fundamental liberties would help overcome the inevitable practical difficulties which would arise during the transition period in regard to the adoption of the relevant Community legislation. In regard to economic aspects, this opinion has shown that, in view of the progress towards a customs union achieved thus far, the adoption of the *acquis communautaire* by Cyprus will pose no insurmountable problems. The Commission is not underestimating the problems that the economic transition poses. However, the economy of the southern part of the island has demonstrated an ability to adapt and seems ready to face the challenge of integration provided that the work already started on reforms and on opening up to the outside world is maintained, notably in the context of the customs union. This opinion has also shown that there will be a greater chance of narrowing the development gap between north and south in the event of Cyprus's integration with the Community.

The Government of the Republic of Cyprus shares this conviction. Even though they object to the conditions under which the application for membership was made, the leaders of the Turkish Cypriot community are fully conscious of the economic and social benefits that integration with Europe would bring their Community.

47. This opinion has also shown that Cyprus's integration with the Community implies a peaceful, balanced and lasting settlement of the Cyprus question — a settlement which will make it possible for the two communities to be reconciled, for confidence to be re-established and for their respective leaders to work together. While safeguarding the essential balance between the two communities and the right of each to preserve its fundamental interests, the institutional provisions contained in such a settlement should create the appropriate conditions for Cyprus

to participate normally in the decision-making process of the European Community and in the correct application of Community law throughout the island.

48. In view of all the above and in the expectation of significant progress in the talks currently being pursued under the auspices of the Secretary-General of the United Nations, the Commission feels that a positive signal should be sent to the authorities and the people of Cyprus confirming that the Community considers Cyprus as eligible for membership and that as soon as the prospect of a settlement is surer, the Community is ready to start the process with Cyprus that should eventually lead to its accession.

49. The United Nations Secretary-General is aware that he can count on the Community's support in his continued endeavours to produce a political settlement of the Cyprus question.

Even before such a settlement is forthcoming, the Commission undertakes to use all the instruments available under the Association Agreement to contribute, in close cooperation with the Cypriot Government, to the economic, social and political transition of Cyprus towards integration with the Community.

If the Council agrees, and in the hope of facilitating the conduct of the future accession negotiations, the Commission is willing to begin immediately talks with the government of Cyprus. These talks would serve to familiarize the Cypriot authorities with all the elements that constitute the *acquis communautaire*, partly in order to allow them to prepare their negotiating position under the best possible conditions and partly to permit an assessment of the need for any technical cooperation and assistance that their country might require to adopt and implement Community legislation and the policies and instruments that will be needed for its integration and to prepare the way, in due course, for the north of the island to catch up economically.

The Commission also undertakes to examine the issue of Cyprus's future institutions and their compatibility with the requirements of active participation in the day-to-day running of the Community in the event of accession.

50. The Community must ensure, moreover, that the general assessment to be carried out in the context of the 1996 intergovernmental conference results in greater efficiency in the operation of the institutions of an enlarged Community — and one that could well be enlarged further — while at the same time providing Cyprus, and any other new Member

State of a similar size, with a guarantee that it will receive appropriate treatment in the decision-making process and in the discharging of its responsibilities.

51. Lastly, the Commission must envisage the possibility of the failure of the intercommunal talks to produce a political settlement of the Cyprus question

in the foreseeable future, in spite of the endeavours of the United Nations Secretary-General. Should this eventuality arise, the Commission feels that the situation should be reassessed in view of the positions adopted by each party in the talks and that the question of Cyprus's accession to the Community should be reconsidered in January 1995.

Part Two — Specific aspects

Agriculture and fisheries

Agriculture

1. Although agriculture in the southern part of the island accounts for only 7.2% of GDP and 12.8% of total employment, it still provides 20% of total exports, which go mainly to the Community (75%) and comprise new potatoes, citrus fruit and grapes. Most farmers have an additional job in one of the urban areas.

In terms of cultivated area, non-irrigated agriculture is preponderant (cereals, fodder, olives, almonds and wine grapes), although it accounts for only 30 to 40% of production by value. The rest, i.e. the bulk, comes from irrigated farming and takes the form of lemons, bananas, fresh vegetables and table grapes. Cyprus imports cereals, animal feed, beef and veal and sheepmeat, and also milk products and sugar.

Cypriot agriculture is strongly organized and receives government aid and protection in various forms. The market is fairly extensively regulated. Production of wheat, barley and grapes receives direct subsidies; State or semi-State monopolies have been established for cereals, olive oil, potatoes and grapes; imports of milk are prohibited and beef and veal imports are covered by strict quota arrangements; imports of the main agricultural and food products are still subject to a licensing system — discretionary for the most part. Coordination between government and trade bodies is close and provides the necessary flexibility to feed the population plus the 2 million tourists who visited the island in 1992, for example. The Protocol on customs union signed in 1987 left this system largely intact and put off completion of customs union for agricultural products until the final stage between 1999 and 2003.

From the budget standpoint (see pp. 29 and 30 — 'Implications for the Community budget'), statistical analysis by product¹ points to the following estimated requirements in the event of accession: ECU 64 million in all, comprising ECU 25 million for cereals, ECU 14 million for sheepmeat, ECU 9 million for wine, ECU 8 million for fruit and vegetables, ECU 6 million for flanking measures and ECU 2 million for oilseeds.

Accession would be unlikely to have any notable impact on production of the typically Mediterranean products, given existing production levels. If Cyprus wished to develop its agricultural production, it would have to do so through diversification. Early-season products such as potatoes and table grapes might even gain from access to the single market. On the other hand, the subsidy arrangements for grapes (and hence also for wine), price-fixing and the ban on milk imports, import quotas for beef and veal and also the various monopolies would have to be adapted. Imports from the mainland would probably increase and consumer prices on the Cypriot market would probably tend to rise.

Fisheries

General

The fisheries sector in the southern part of the island makes only a marginal contribution to the country's economy (0.3% of GDP).

As production cannot meet national demand, Cyprus relies heavily on imports, which far exceed its exports; the resulting trade deficit was ECU 18.3 million in 1991, including ECU 6.2 million in trade with the Community. Cyprus applies preferential rates to imports from the Community, but the Community grants no preferences to Cyprus, other than under the generalized preferences system.

Adaptation to the acquis communautaire

The Cypriot authorities have proved themselves capable in the conservation and efficient management

¹ Assuming the following:

- (i) CAP reforms to apply in full as from the entry into force of the accession treaty;
- (ii) accession to take place at a point when the reformed CAP will be fully operational.

of stocks. The accession of Cyprus would, however, have to be accompanied by a strengthening of the necessary research and inspection resources (equipment, institutions and staffing).

Given its size, the Cypriot fleet could probably be incorporated into the Community fleet without difficulty. It will be necessary to see that the loans scheme in this sector is in line with Community directives.

The main problem concerning the Cypriot fishing fleet relates to the registration of fishing vessels with foreign owners. The Community will be unable in any circumstances to accept such a practice and flagging terms will consequently have to be aligned on those in force in the Community.

Generally speaking, the aquaculture sector in Cyprus is marginal compared to that of the Community. However, the rapid development of fry production, especially of sea bass and sea bream, may have some effects on the hatchery sector in some Community Mediterranean countries.

Adoption of every aspect of the common organization of markets could present administrative problems for Cyprus, as no legislation exists on pricing systems, trade bodies or marketing and quality standards.

The existing restrictions or prohibitions, the import-licensing system and the income support measures are contrary to established Community rules and practices.

Lastly, the State aids which represent operational assistance for firms would also have to be abolished.

Conclusion

The size and nature of the Cypriot fishing fleet are such as to suggest that its incorporation into the Community fleet would not be difficult.

The hardest task for Cyprus would lie, from the administrative standpoint, in adopting all aspects of the common organization of markets.

Internal market and industrial affairs

Industry in Cyprus¹

2. Unlike agriculture, industry has been of growing economic importance in the southern part of the island during the last 10 years. In 1990, manufacturing industry contributed 14.5% of GDP at current prices, accounted for some 20% of the employed workforce — estimated to number 252 700 in 1990 — and provided 73% of total exports of locally produced products. The corresponding figures are lower for the northern part of the island, which possesses 25% of total industrial capacity, as well as the copper mines. In the north, manufacturing industry contributed 11.5% of GDP at constant prices in 1991, accounted for 9.5% of the employed workforce and, in 1990, provided 54% of total exports.

In the southern part, nevertheless, industry is less important economically than the service sector, particularly tourism and trade, which between them accounted for 21.3% of GDP in 1990. The service sector also has a higher growth rate, reaching 10% in 1988 and 1989, whereas manufacturing production growth slipped back from 7% in 1988 to 3% in 1989 and 1990. The average growth rate for manufacturing has also fallen back in the northern part since 1990, though for different reasons, from a level of over 15% to below 5%.

Industrial development in the southern part will depend on light industry, notably the clothing, agri-food, furniture, footwear and metalworking sectors, which account for 75% of total industrial production.

In value terms, the food industry is dominant (26.8% of industrial added-value), followed by textiles and clothing (18.5%). Leaving aside the two cement works in operation, the food industry also has the highest productivity and the heaviest investment.

The biggest employer, on the other hand, is the textile and clothing sector, with 30% of the industrial workforce — against 18% for the food industry; it is also the main export industry, with the Community as its chief market. The wood and furniture industry employs 12% of the workforce and accounts for 10.4% of added value. Chemicals are also important,

¹ Detailed information on industry relates only to the situation in the southern part of the island.

employing 5.2% of the labour force and accounting for 7.3% of added value.

Cypriot industry is dominated by family firms and is viewed by the World Bank as being seriously deficient from the standpoint of the technology in use, workers' skills and production quality. Not having undergone any process of rationalization or specialization, many industrial firms would be very vulnerable to international competition on both external markets and the domestic market.

The studies on specific sectors carried out by the Commission on the basis of the information available back up this assessment, particularly in the case of the footwear industry, whose lack of competitiveness is put down to structural weaknesses such as absence of specialization, the shortcomings of labour (both skilled and unskilled), poor management, difficulties with supplies of raw materials and lack of innovation.

Chemicals, notably on the organic side, together with electrical and mechanical engineering, are also considered to be vulnerable, with Cypriot products in the latter two sectors being markedly inferior to Community products.

Cyprus's dependence on external markets, especially the Community market, for its supplies of chemicals and also engineering, electrical, electronic and transport equipment should be noted.

Notwithstanding the measures already adopted to dismantle tariffs and approximate the Cypriot customs tariff to the Community customs tariff, Cypriot industry still operates behind high tariff barriers, duties of over 50% being not unusual, even on Community products, in sectors where there exists a local industry.

Cypriot industry also enjoys varied forms of official assistance for investment and exports. The first category includes exemptions from customs duty, tax concessions to promote the modernization of firms and the creation of jobs for graduates, facilities to encourage the establishment of firms in the seven industrial and regional development areas — soon to be joined by three more — and also further tax advantages for firms setting up in the Larnaca free zone. On top of all these there is the government guarantee for industrial schemes helping to modernize local industry and make it more competitive, the granting of loans on favourable terms for industrialists who moved from the north of the island following the events of 1974, and grants for industrial firms

setting up in rural areas. Export aids take the form of export guarantee arrangements (government guarantee for obtaining finance, export credit insurance), the halving of tax on export earnings from products manufactured locally, and the refund of customs duties charged on raw materials used in the manufacture of export products.

There has been little encouragement in the past for foreign investment in industry, despite the fact that it can be a source of technological progress; in the traditional industrial sectors, there are rules preventing non-residents from taking a majority holding; in the most sensitive sectors, such as pumps and turbines, furniture, leather and footwear and the food industry, the maximum holding is normally 24%; in exceptional cases it may rise to 49%, if the proposed investment is regarded as particularly advantageous. However, the restrictions do not apply to new industries, nor to industrial or commercial projects geared exclusively to export.

Adapting Cypriot legislation to the *acquis communautaire*

Because of the lack of adequate information on existing legislation in Cyprus, it is difficult at this stage to assess the extent to which approximation to Community legislation has already taken place.

In the sphere of technical rules, i.e. standardization and conformity testing, alignment of Cypriot legislation on that of the Community is a priority target for the Cypriot authorities. It would seem that this alignment is either already partially under way or is being prepared. It will be necessary to check, however, whether the technical specifications currently in force in Cyprus are optional or mandatory, as this is crucial for assessing the arrangements for testing the conformity of products to technical rules. It should also be noted that Cyprus is still not a party to the GATT Agreement on technical barriers to trade.

With regard to intellectual, industrial and commercial property, the Cypriot authorities point out that they have either already adopted measures to align local legislation on Community rules or that they are preparing such legislation. Nevertheless, it is considered that there are still gaps in Cypriot legislation where it should correspond to the Community *acquis*.

Similarly, there will certainly have to be changes in the rules currently governing public procurement,

where the requirement for national preference is incompatible with Community rules.

Impact of accession on Cypriot industry

The instruments providing the means for Cypriot industry to adjust to the Community's single market and the implications of the common commercial policy already exist. This is because, even while the accession of Cyprus to the Community is still only a possibility, application of the Association Agreement and the 1988 Protocol providing for completion of the customs union by the end of the second stage will compel Cypriot industry to adjust progressively to a market open to competition not only from Community firms but also from non-Community countries.

It would seem, however, that the Cypriot business community is adopting a wait-and-see policy; though fully aware of the need to reorganize their business methods, they are putting it off until competitive pressure starts to become a reality. It is impossible, therefore, to overestimate the need for the proper application, in accordance with the agreed timetable, of the instruments referred to above. This would appear to be the best means of ensuring that Cypriot industry — given the vulnerability to which attention has already been drawn — is given a smooth preparation for the new situation.

As for Cyprus taking over Community legislation, the 1988 Protocol ensures that certain principles of the EEC Treaty will be applicable in relations between the two parties in the context of the association. They include the competition rules, tax provisions and the article on approximation of laws. It is also stipulated that provisions for implementing these principles are to be adopted by mutual agreement not later than the start of the second stage. Hence this should normally take place in 1998. The new period then beginning will provide an opportunity for any additional adjustments required.

It is of vital importance that the industrial restructuring and reorganization programme being implemented by the Cypriot Government be carried out effectively. The aim is to help the productive sector become more flexible and better adapted to the changing conditions of the world market. It should be observed that the policy initiated by the govern-

ment is geared to modernization of the main existing industries, i.e. the food industry, clothing, footwear, furniture and metalworking, rather than to conversion and the development of new industrial activities.

Customs and indirect taxation

Customs union

3. In the event of accession, Cyprus will have to adopt the whole of the Community customs *acquis*. Should Cyprus so request, transitional arrangements could probably be made, with a view to allowing the Cypriots to adjust fully to the Common Customs Tariff and the provisions of the Community Customs Code.

With regard to computerized customs clearance, the Cypriot administration is currently engaged in setting up a system with a view to computerization of the tariff and importers' databases, the introduction of the Single Administrative Document and the automatic calculation of customs duties and VAT from 1993 onwards. This would constitute a first step towards the upgrading of procedures which will be necessary to match Community standards.

Along with the Common Customs Tariff, Cyprus would also have to adopt the Combined Nomenclature, which is considerably more detailed than the Harmonized System currently in use in Cyprus.

Customs legislation proper, which forms part of secondary legislation, will have to be adopted by Cyprus, subject naturally to certain adjustments during the transitional period.

Taxation

Value-added tax

Since 1992 Cyprus has been operating a VAT system based on that of the Community. In principle it is a single-rate system which is notable by being very low, i.e. 5%. However, zero-rating, i.e. exemptions with credit for previously paid VAT, is applied to a range of goods and services such as foodstuffs, water sup-

plies, pharmaceutical products, newspapers, periodicals and books, children's clothing and footwear, urban and rural bus services, fertilizers and agricultural machinery, etc.

As for the taxable person's right to deduction for goods and services used for the purpose of his taxable transactions, the rules are in general similar to those set out in the Community VAT legislation. However, arrangements for refund of VAT to taxable persons not established in Cyprus still have to be enacted.

Cyprus does not operate any flat-rate or similar scheme for small farmers. However, farmers are not required to register and most of their inputs and outputs are covered by the zero rate.

The processing of the VAT returns is computerized and is based upon a system developed for the Danish VAT system, adapted to Cyprus's requirements.

The VAT system applied in Cyprus conforms, in the main, to the VAT system of the Community. In the event of Cyprus's accession certain technical adjustments would be needed, in particular as regards the rate level. Adjustments regarding the adoption of the new intra-Community VAT system will also be required.

Excise duties

In addition to VAT, Cyprus levies excise duties on a limited range of goods such as alcoholic beverages, tobacco products, mineral oils and soft drinks. In addition to customs and excise duties, imported goods are subject to the payment of a temporary levy. This levy will need to be abolished in the event of Cyprus's accession. Furthermore, imported goods will need to be treated the same way in respect of taxation as similar domestically produced products.

Employment, working conditions and social affairs

4. The information available would suggest that, broadly speaking, the accession of Cyprus would not raise major difficulties in the social sphere.

The social situation in Cyprus is comparable in many respects to that of the Community Member States and should enable it, in the event of accession, to take over the Community *acquis* in social matters without too many problems and with only a few adjustments.

Employment

For a long time there has been little unemployment, and the level has stayed below the high Community rates of the last 10 years. Neither women nor men are particularly disadvantaged by unemployment and there is relatively little youth unemployment. Similarly, the long-term jobless are few in number.

Health and safety at work

Cypriot legislation is similar to that of the United Kingdom. Cyprus is at present adopting draft legislation for transposing Community directives into national law.

Free movement of workers

The number of work permits issued to Community nationals by the Cypriot authorities has been fairly stable since 1986. In 1990 nearly 9 000 permits were issued, more than half of them to British nationals. The permits are valid for one year.

Labour law and industrial relations

Collective bargaining is the foundation of the Cypriot labour relations system and there is a strong tripartite tradition.

Labour legislation is kept to a minimum: it forms a framework in which the main principles established are freedom of association and the right to strike. There is also some legislation on protection of certain

vulnerable categories of workers on the labour market.

In the event of accession, Cyprus would in any case have to adopt certain adjustments in line with specific Community directives (maintenance of workers' rights in cases of transfer of ownership of firms, and protection of wages or salaries due in cases of bankruptcy of employers).

Equal treatment for women and men

Here too, in order to be fully in line with Community law, Cyprus would have to adjust somewhat its current legislation or contractual provisions in such matters as equal treatment, equal pay and the protection of pregnant women. The same applies in the case of the directive on equal treatment for men and women who are self-employed, including in farming.

Application of the EEC social security Directive (statutory systems) does not present major difficulties; in occupational schemes there is still a degree of discrimination.

European Social Fund

In the context of aid granted under the Structural Funds, some operations could be considered as coming under Objective 1 and hence could take the form of operations to develop human resources (training and employment).

Certain data would seem to indicate significant investment in implementing social policies. The percentage of GNP allocated to education and training (5.3% in 1990) compares to the Community average and is higher than in some Member States. Illiteracy would appear to be non-existent and the educational qualifications of people in employment seem to be fairly high: for example, 17% of the active population is of graduate level. On the other hand, the staying-on rate for young people between 15 and 19 years of age is rather low, as compulsory schooling ends at the age of 15. Administrative services (notably the employment services) are of good quality.

The above considerations suggest that any operations undertaken to combat unemployment under the

European Social Fund would be relatively marginal from the standpoint of the Community, though by no means negligible for Cyprus.

Competition

Competition rules for companies

5. The relevant legislation is the law to ensure competition, which was adopted in 1989 and entered into force in June 1990. It reproduces the text of Articles 85 and 86 of the EEC Treaty, and also certain provisions of Regulation No 17. A close watch will have to be kept, however, on State-controlled undertakings, which are not covered by the legislation.

With regard to merger control, there is a requirement that mergers must be notified not later than 30 days after they take place, which raises a question mark over the effectiveness of such supervision.

Although there is as yet little case-law, there has been one instance in the insurance sector, where the Commission objected to joint price-fixing practices.

The conclusion to be drawn from the foregoing is that the Cypriot legislation dating from 1990 approximates to that of the Community, but it is too early to pronounce on the effectiveness of its implementation.

State aids

Government guarantees are given for a number of purposes (e.g. industrial projects, tourism, exports). It is not clear whether these guarantees are given under commercial conditions and whether in case of losses incurred on guarantees the Cypriot Government claims from the recipient the amount due, if necessary by legal means. The above is especially important in the case of the export sector. If State aids are involved, it should be pointed out to the Cypriot authorities that the Commission does not approve of any aid for exports within the Community.

Except for special facilities for export-oriented companies and the tourist sector, no information has been given about aid programmes directed at specific

sectors. However, it should be signalled to the Cypriot authorities that schemes which grant aid to companies in general are restricted in what concerns aid to companies pertaining to industrial sectors covered by specific Community policy statements, and also aids to the agricultural, fisheries, transport and coal sectors.¹

For the establishment of industrial estates and free zones, the aid element must be evaluated and cumulation conditions with other aids must be specified. This may constitute an operating aid, and such is normally not acceptable. In addition, the free zone may include some export aid that would not be acceptable.

No aid is mentioned for research and development (R&D). If State aid for R&D is granted to companies, the necessary information should still have to be provided.

As regards public undertakings and holdings in which the government participates several points should be mentioned. For example, it is not clear whether the conditions on the transparency of financial relations are fulfilled or whether the activities are in line with the Commission's communication on public enterprises in the manufacturing sector.

A first assessment of the State aids situation in Cyprus shows that the information provided is still incomplete (tax exemptions, tax incentives, regional aids, loans for industrial restructuring, role of the Cyprus Development Bank, etc.). In view of the extent of the Cypriot economy, the probable size of the companies involved and the nature of their activities, it is however likely that in many cases the threshold of *de minimis* rules will be exceeded.

State monopolies — Undertakings with special or exclusive rights

Trading monopolies

There are monopolies in Cyprus for electricity, oil and wine. Various restrictions relating to these monopolies are clearly contrary to Articles 30, 34 or 37 of the EEC Treaty.

Public undertakings

The Cypriot authorities contend that there is full transparency of financial relations between public authorities and public undertakings, but no details appear in the available information.

In the telecommunications sector, the Cyprus Telecommunications Authority (CTA) is the only authorized body for the provision of telecommunications services in Cyprus. The Cypriot authorities recognize that the present legislation would be incompatible with Community law. Some further liberalization is also needed in the field of telecommunications equipment.

The postal service has an overall monopoly, except for express mail services, which are provided both by the public service and by private firms. The Cypriot Government is at present examining the legal framework for the postal service with a view to institutional reform.

There do not appear to be any special or exclusive rights in Cyprus for air or sea transport.

Financial institutions, company law and direct taxation

6. On the basis of the available legislative information, which is quite limited, the situation appears to be as follows.²

Banks

The Central Bank of Cyprus has prepared a new banking bill, the purpose of which is to modernize banking practice and align it with most EC banking legislation.

EC banks appear to receive national treatment as regards both establishment and the carrying-on of

¹ Aid to the agricultural and transport sectors has not been covered in the present analysis.

² Only valid for the southern part of the island.

activities. Two EC banks have branches in Cyprus and one is incorporated as a subsidiary. The establishment of offshore business¹ is also allowed for foreign financial services firms, subject to specific conditions.

Insurance

EC insurance companies appear to receive national treatment as regards both establishment and the carrying-on of activities. They may be established as either a subsidiary or as a branch. The number of EC insurance companies present is 25, onshore and offshore.

Securities

The present Cypriot securities market is an unofficial over-the-counter market, which does not have any EC presence.

A stock exchange bill has been submitted to Parliament providing for the development of the securities market, the establishment and operation of a Cyprus Stock Exchange, the establishment of a Stock Exchange Council and other related matters. This proposal does not contain any reference to access or to operation by foreign companies.

Company law and direct taxation

The Commission is not in the possession of any legislation pertaining to company law and direct taxation.

Assessment

It is not possible to assess at this stage which specific points concerning the application of Community law pertaining to financial institutions, company law and direct taxation will need to be addressed in the accession negotiations. Although the laws of Cyprus generally set the framework for national treatment

pertaining to establishment and the carrying-on of activities, the legislation does not go as far as EC legislation, so the following comments are called for.

Acquis communautaire

The *acquis communautaire* must be accepted by Cyprus. However, the full implementation thereof may be deferred for a short period of time to allow the appropriate legal and administrative adaptation. While any transitional period should be of strictly limited duration, sensitive questions could arise regarding the capacity of the authorities of Cyprus effectively to apply the prudential regime imposed by the Community directives.

Approximation of laws

The Association Agreement with Cyprus does not contain provisions relating to financial services, company law or direct taxation. Although Cyprus has decided to align its legislation with Community law in these areas specific efforts appear only to have been made in the banking area. Cyprus should be encouraged to align its legislation in the other areas as quickly as possible, as this would facilitate the accession negotiations.

Conclusion

It would be useful if the authorities of Cyprus could be persuaded to continue and intensify the exercise of approximation of laws in the area of financial institutions, company law and direct taxation.

¹ Offshore banks are licensed to carry on banking business from within Cyprus but wholly on an offshore basis. Their banking business is restricted exclusively or predominantly to persons who are not permanent residents of the Republic of Cyprus and to currencies other than the Cypriot pound.

Energy

7. Cyprus has no indigenous energy resources and is therefore completely dependent on imported energy, particularly oil, with 50% of export earnings being spent on petroleum products. There is some scope to develop hydroelectric power and other renewables such as solar-power heating, which is already well established in the domestic sector. Total final energy consumption in Cyprus is 1.2 million toe (1990) compared to 723 million toe in the Community. Energy intensity in Cyprus (gross inland consumption/GDP) in 1990 was 610, more than double the EC figure of 286. Cyprus is taking steps to encourage energy efficiency and conservation to reduce the growth in energy demand. This is done mainly by the private sector with supportive measures and fiscal legislation by the government.

Electricity power generation (+/- 500 MW) is oil-based and uses about a third of oil imports. Electricity generation and supply is the sole responsibility of the Electricity Authority of Cyprus, which supplies the whole island, for which there is an integrated grid network, an important link between the two parts of the island. A major problem for this Authority is the unbilled consumption of electricity supplied to the Turkish community.

In the event of accession to the Community, Cyprus may have some difficulty in meeting the Community's crisis and stock directives. It is not a member of the International Energy Agency. Moreover, at the moment stocks to meet only around 30 days' oil consumption are held. Information on the north of the island is not available. Given its vulnerability to developments in oil markets, the government is currently reviewing this situation. Cyprus may also find difficulty in conforming to directives prohibiting the development of new oil-based generating units in the future expansion of its electricity-generating system. As regards the environmental impact of energy use, at the moment power generators do not operate in conformity with EC directives, although steps are being taken to remedy this.

In conclusion, given Cyprus's island situation, somewhat remote from the existing Community of Twelve, its energy situation will have little impact on the Community's energy situation and present energy policy development. On the other hand, Cyprus will have to adapt or introduce legislation to meet EC requirements in the energy sector.

Environment

8. It can be said that there is no major environmental problem in Cyprus. Given the specific geographic, climatic and economic conditions, some issues are of more particular importance than others, for instance: ensuring a sustainable development of industrial, tourist and agricultural activities; protection of the scarce water resources; preservation of the quality of the marine environment and of the natural assets of Cyprus, and management of waste.

Existing contacts between the Community and the Cypriot authorities show the obvious willingness and also the capacity of Cyprus to conduct a sound environmental policy, based on its integration with the overall development policy. Approximation of Cypriot environmental policy and legislation with those of the Community is actively sought and has already taken place in some fields.

The most recent environment-specific legislation adopted or planned for adoption is based on principles in line with relevant EC legislation. This concerns areas such as water and atmospheric pollution, dangerous substances, noise or industrial effluents.

Therefore one may well conclude that as long as this trend is followed and cooperation between the Community and Cyprus continues on the same basis, Cyprus would not meet any major difficulty in integrating EC environmental policy and legislation into its system in the event of accession. It would only benefit from the expertise and experience acquired already at EC level, including in areas not yet tackled by Cyprus.

Telecommunications

9. The information available indicates that the current legislation covering telecommunications, which confers on the CYTA¹ both regulatory functions (or the responsibility for preparing decisions) and operational functions, and also gives it a monopoly over the supply of services, is incompatible with Community rules. Should negotiations take place on accession, the Cypriot authorities would have to

¹ Cyprus Telecommunications Authority.

adopt appropriate measures in this respect, subject to the usual transitional provisions.

In many other respects, however, accession would raise no particular difficulty. An example is standards, where the CYTA applies both international standards and those set by ETSI,¹ of which Cyprus was a founder member. The same applies to telecommunications terminal equipment, for which the market was liberalized in 1989.

Moreover, in the southern part of the island the network is well developed. With 46 direct lines for every 100 inhabitants, Cyprus stands slightly above the overall average for the Community and EFTA (43); in addition new services covering data transmission, fax and mobile phones are already available.

Transport

Road transport

10. With regard to market access, public transport in Cyprus is subject to licences. A majority of Member States have signed international road transport goods agreements with Cyprus.

In the areas of social legislation, technical standards, taxes and road safety, there exists a legal basis. Current legislation concerning environment and public health is minimal.

Sea transport

Conditions for the establishment of shipping companies in Cyprus and accession to its flag are too loose as compared with those generally applied by EC Member States.

Operating conditions under the Cyprus flag may raise problems of distortions of competition due to low taxation and the non-existence of crew nationality requirements.

Moreover, the degree of implementation of international standards of safety and pollution prevention differs from the average for the Community fleet.

Aviation

Air transport is largely governed by traditional bilateral agreements. Cyprus has signed 35 bilateral agreements, including with all EC Member States. Cyprus is a signatory of the ICAO as well as of Euro-control and ECAC agreements.

Regarding market access and ownership and air fares, restrictions are much less apparent in the Community than they are in Cyprus.

Conclusion

In the course of any accession negotiations, the following would have to be discussed in detail:

- (i) road transport: legislation on social aspects, environment, public health and technical standards;
- (ii) maritime transport: cargo reservation, conditions for registration and the implementation of maritime safety and pollution prevention standards;
- (iii) aviation: the legislation concerning the liberalization process.

Enterprise policy and tourism

11. The Cypriot economy is dominated by small and medium-sized enterprises. Enterprise policy is general in nature, rather than being targeted according to the size of businesses, as this meets the Cypriot Government's main aims of encouraging investment in rural areas (by means of grants), stimulating exports (through guarantees and grants for missions) and implementing industrial projects (guarantees, grants for studies on restructuring).

Since mid-1992 Cyprus has been connected to the BC-Net network and it is planned to set up a Euro-Info Centre in 1993/94.

The recent growth of tourism in Cyprus is impressive. For example, both the number of beds available and

¹ European Telecommunications Standards Institute.

the number of tourists visiting the island more than doubled between 1985 and 1990.

Since 1990 the government has been pursuing a tourism policy aimed at a more targeted growth in tourist numbers and also a more varied range of tourist attractions, with the aim of achieving an increasingly even spread of tourist visits throughout the year.

This is entirely consistent with Commission policy in this field.

Conclusion

It is clear from the foregoing that the accession of Cyprus would not present any special problems in respect of enterprise policy or tourism.

Consumer policy

Health and safety

12. The information available does not permit a conclusive assessment regarding the general safety of products. It would appear, however, that the rules in force in Cyprus would have to be revised completely in order to be brought into line with the relevant Community directive.

The current regulatory situation in Cyprus with regard to cosmetics is incompatible with Community rules.

Consumer transactions

There does not appear to exist any legislation at present comparable to the Community legislation on the following: misleading or comparative advertising, package holiday tours, timesharing, contracts other than those negotiated in commercial establishments and unfair clauses in contracts. It would therefore be necessary to incorporate the Community directives into Cypriot law.

Information and protection of consumers' economic interests

In the case of textiles, the provisions contained in the Community directives have to a large extent been incorporated into Cypriot legislation, but gaps — major ones in some cases — still exist. It would also appear that the Cypriot rules concerning labelling of products and analytical methods used in conformity testing are merely optional, and this would not be acceptable.

Cypriot legislation on the labelling of foodstuffs does not present any special problems, even though generally speaking it falls short of the relevant Community directives.

In the matter of the pricing of foodstuffs and non-food products, Cypriot legislation is far removed from the relevant Community directives and major adjustment efforts would be required.

To sum up, the accession of Cyprus would entail adjustments to Cypriot legislation on consumer policy, and in some cases the adjustments would be substantial.

Implications for the Community budget

13. The estimate of the budget impact was drawn up on the assumption that the Community *acquis* will apply, and on the basis of the Community budget adopted for 1992.

It was not possible to allow for any dynamic aspects of the impact of accession on the economic structure of Cyprus,¹ the main features of which from the budget standpoint are as follows:

- (i) agricultural production accounts for some 7% of gross domestic product and falls short of ensuring self-sufficiency, as indicated by the fact that imports of agricultural products exceed exports by over 20% in value terms;
- (ii) external trade is substantially in deficit because of the considerable need for intermediate products to

¹ For example, changes in trade flows or the structure of agriculture.

be used in production and the demand for manufactured consumer goods. Trade with the European Community accounts for over half of total trade flows;

(iii) GNP in Cyprus is equivalent to some 1% of that of the Community, which corresponds to a per capita average of 48% of the Community level. In the northern part of the island, the average is only one third of the level in the southern part (namely 19% as against 55% of the average per capita Community GNP).

In the light of all this the following quantified estimates have been arrived at:

Expenditure

Agricultural expenditure

A basic calculation was carried out by product in the light of the recent developments in the common agricultural policy. The assumptions used concern both economic parameters (production, consumption, trade, unit assistance rates, etc.) and structural ones (numbers of persons involved in agriculture, herd numbers, etc.).

Total requirements were estimated at some ECU 60 million, including ECU 24 million for cereals and ECU 14 million in the sheepmeat sector.

These figures are a guide only, since the statistics available are not sufficiently detailed.

Structural Funds

Given the average per capita GNP of Cyprus, applying the amount of aid per head of population for Greece, taking all regional and social assistance (including the integrated Mediterranean programmes) together, to the population of the island results in a figure of around ECU 120 million, the distribution of which between the two parts of the island would be established at the appropriate time. This figure covers contributions from the Regional Funds, the Social Fund, the EAGGF Guidance Section and assistance for the fishery sector.

Other policies

Applying the GNP ratio in respect of industrial policy expenditure and the population ratio in respect of administrative expenditure results in figures of ECU 3 million and ECU 4 million respectively.

Language

In present circumstances the accession of Cyprus would involve a further language (Turkish) which would require some 200 translators and interpreters at an annual cost of around ECU 8 million.

Income

Own resources as traditionally defined would bring in an estimated ECU 55 million, given the level of trade, and would comprise ECU 8 million from farm levies and ECU 47 million from customs duties. At the same time accession would result in an estimated drop in budget receipts of ECU 6 million. Resources from VAT and GNP would bring in ECU 39 million and ECU 14 million respectively.

Conclusion

In budget terms the accession of Cyprus might result in increased expenditure of ECU 195 million, notably on account of payments from the Structural Funds. Income would increase by ECU 96 million, however, due allowance being made for the loss of duties and levies on trade between Cyprus and the Community and the costs of collection. Overall, therefore, accession would represent an additional budget cost of some ECU 100 million.

Cooperation in the fields of justice and home affairs

14. The Cypriot Government has undertaken to meet all obligations and responsibilities deriving from the Treaty on European Union. This implies

acceptance by the Cypriot authorities of all decisions concerning cooperation in the fields of justice and home affairs as set out in Title VI of the Treaty on European Union.

The involvement of Cyprus in the obligations resulting from Title VI of the Treaty could entail a major effort on the part of the authorities of the island in order to ensure that all the necessary means are employed so that full cooperation in the areas concerned becomes a reality. The extent of this effort can be established only by joint examination of the details of the relevant *acquis*.

Community regional policy

15. Given the total population (around 700 000) and the average size in population terms of the NUTS 2 regions of the Community, Cyprus would constitute a unique NUTS 2 region.¹ Under Community rules the regions eligible under Objective 1 of the Structural Funds are NUTS 2 regions whose per capita GDP is, over the last three years, less than 75% of the Community average.

According to the various estimates available, it would appear that Cyprus as a unique NUTS 2 region, could be included under Objective 1.

Statistics

16. On the basis of the limited information available and the few bilateral contacts which have been made in the past, the situation appears to be as follows.

The Cypriot statistical system

The statistical system of Cyprus is based around the Department of Statistics and Research (DSR) which is a separate department of the Ministry of Finance. It was founded under the British colonial administration. Since independence in 1960 the government has drawn up a succession of five-year development plans in statistics.

The DSR fulfils a role similar to that of a centralized national statistical office in one of the Member States. We have limited knowledge of the workings and resource base of the DSR, but its publications have a full set of statistical information in the economic, agricultural and social fields.

Statistical law

As in many EC Member States there is a legal act underpinning statistical activities. This was passed in 1968 and empowers the DSR to collect any necessary statistical information and protect its confidential nature. This outlines the rights and responsibilities of the DSR. The subject of confidentiality is becoming increasingly important with Community statistics.

Assessment

Given the size of the country, Cyprus has a relatively well-developed statistical system which could, given the necessary resources, be adapted to the statistical *acquis* after a reasonable transition period.

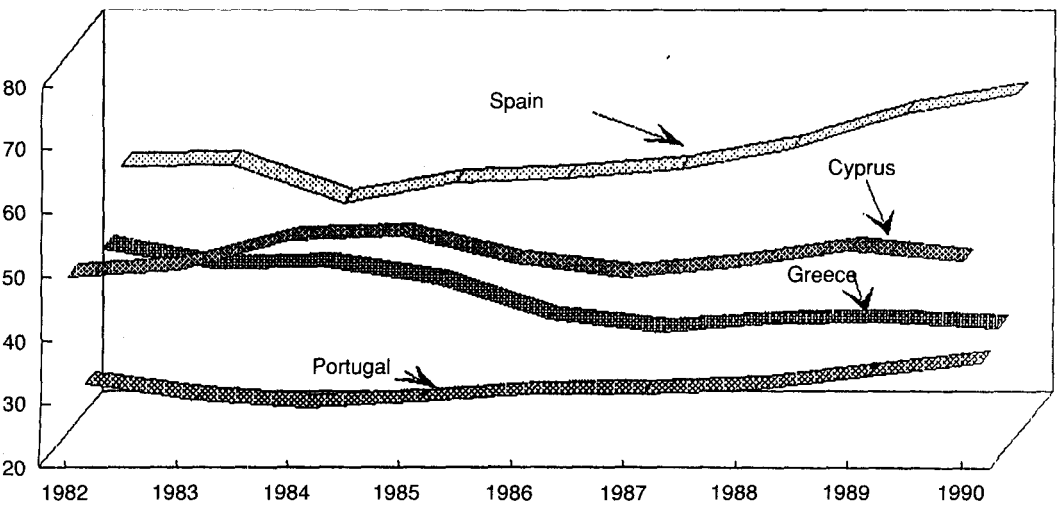
The subject areas covered by the DSR are broadly in line with the statistical requirements of the Community. There is, however, no guide to the quality of the statistics produced (this is particularly important in the fields such as national accounts where statistical data are used to determine contributions to the EC budget). This type of information would have to be obtained at the time of the start of membership negotiations.

¹ NUTS: nomenclature of territorial units for statistics (Eurostat), subdividing the territory of the Community into statistical regions.

Statistical annex — Main economic indicators

Graph 1 – GDP per capita at current prices and exchange rates

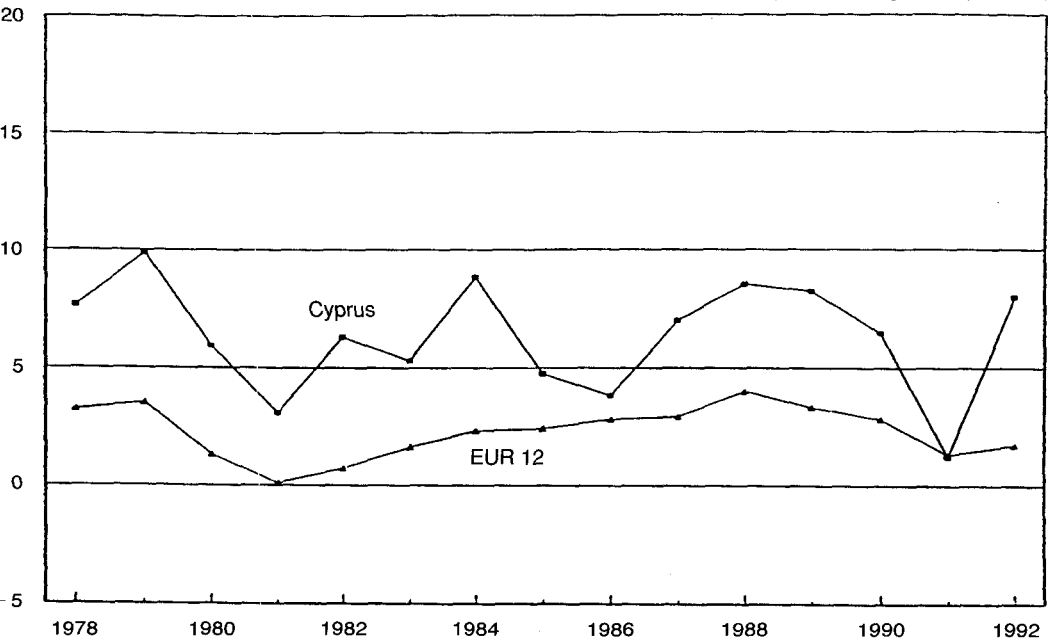
(% of EC average)



Sources: IFS and Eurostat.

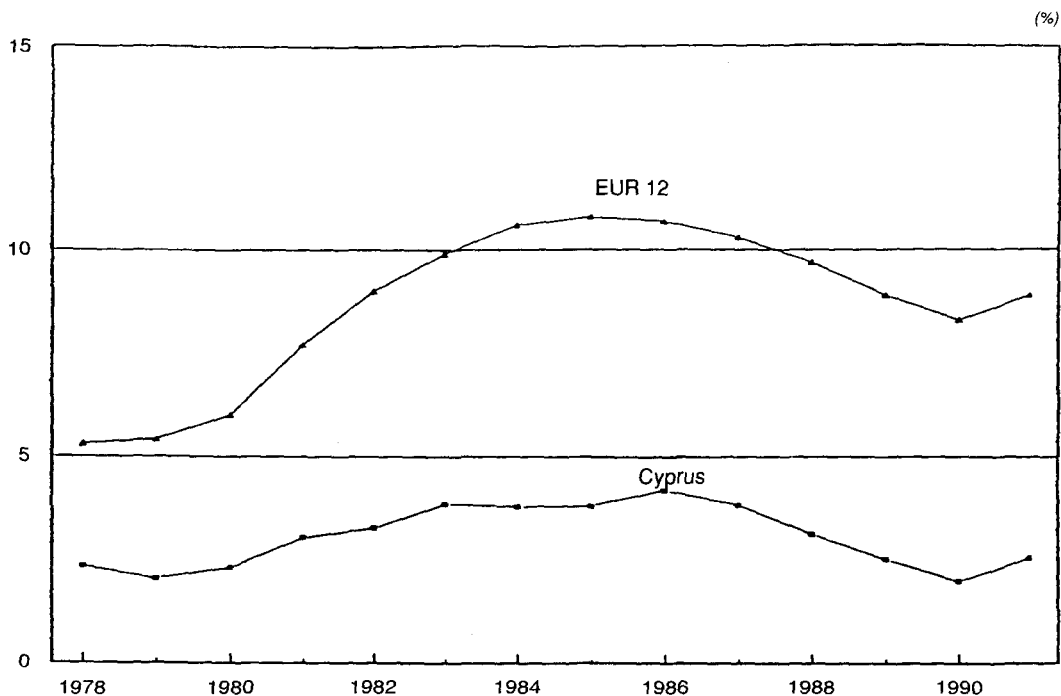
Graph 2 – GDP in Cyprus and the EC, 1978–92

(Annual volume growth; % per annum)



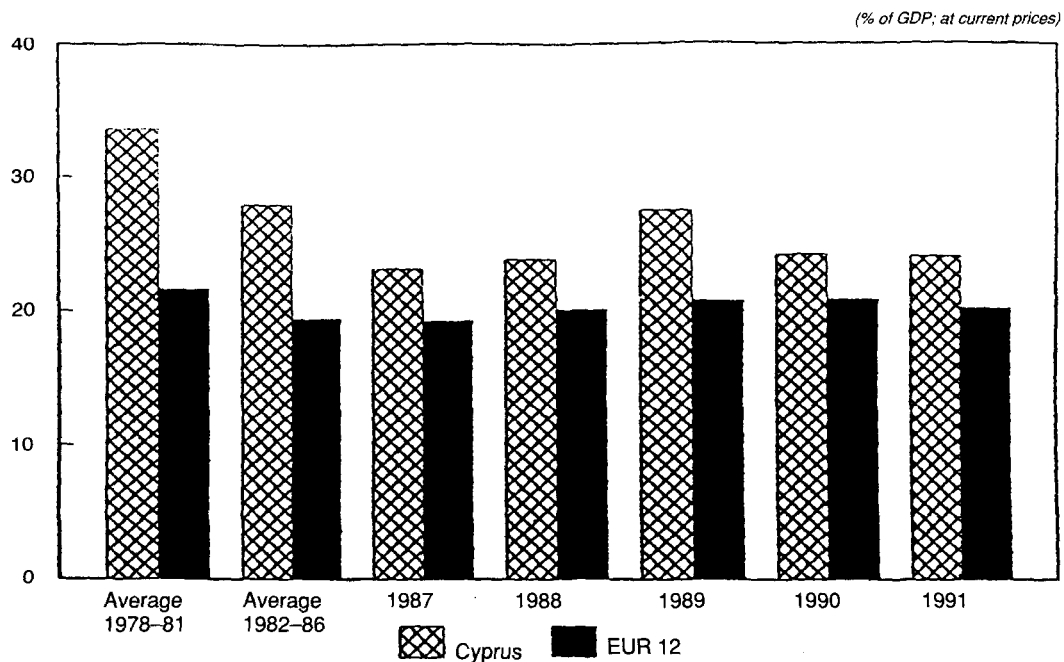
Sources: Eurostat, EC Commission services and Cypriot Ministry of Finance.

Graph 3 – Unemployment in Cyprus and the EC; 1978–91



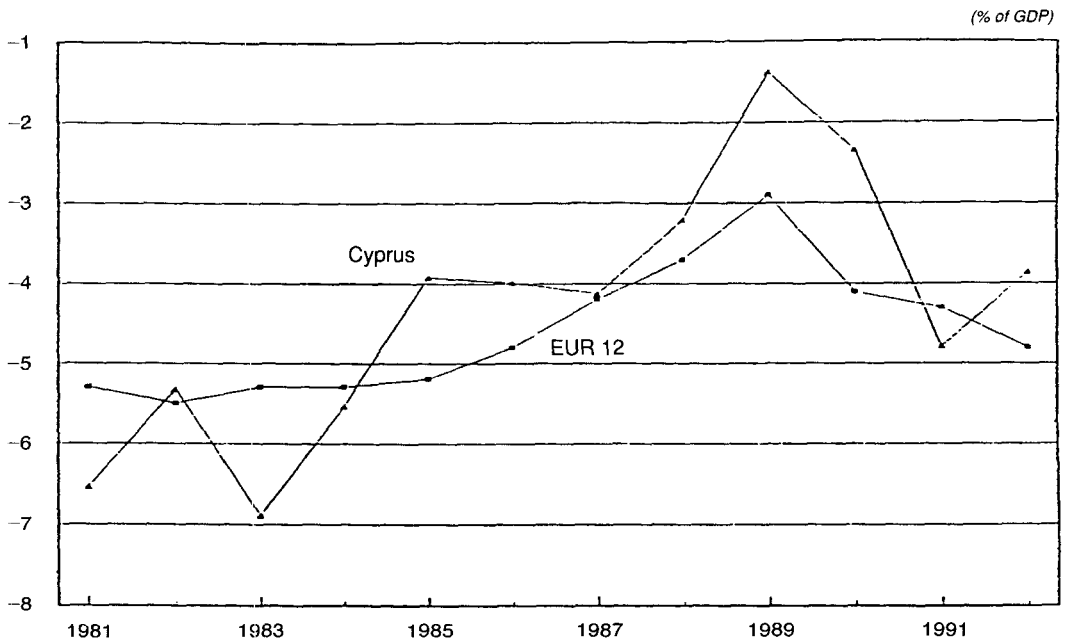
Sources: Eurostat and national sources.

Graph 4 – Investment/GDP ratio in Cyprus and the EC, 1978–91



Sources: EC Commission services and Cypriot Ministry of Finance.

Graph 5 – *Public deficit*



Sources: EC Commission services and Cypriot Ministry of Finance.

Cyprus — Profile

- I. Area: 9 250 km²
 II. Population: 700 000 (1990)
 of which working population: 277 000

III. GDP per capita: ECU 9 000

IV. GDP growth rate (%)

1988	1989	1990	1991	1992
8.6	8.3	6.5	1	8

V. Inflation rate (1991): 5.1%

VI. Unemployment (1991): 1.8%

VII. Structure of employment and GDP (1990)
 (%)

	Employ- ment	Source of GDP
Agriculture	14	7
Industry	20	15
Services	57	68
Construction	9	10

VIII. Trade relations (1991)

(Mio USD)

Imports	2 621
Exports	951
Trade balance	-1 670
NB: Tourism income	1 243

Trade structure

(% of 1991 total)

	Imports	Exports
Manufactured goods	34	41
Transport equipment	28	12
Food products, beverages	15	35
Mineral fuels	10	5

Community share (1991)

(%)

in Cypriot exports	43.4
in Cypriot imports	51.1

EC-Cyprus Trade (1992)

(Mio ECU)

Imports	596
Exports	2 029
Trade balance	1 433

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