

REGULAR REPORT

FROM THE COMMISSION

ON

CYPRUS'

PROGRESS TOWARDS ACCESSION

COM (98) 710 final
17 December 1998

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INTRODUCTION

a) Context of the report

The conclusions of the European Council in Cardiff stated that “The European Council welcomes the Commission’s confirmation that it will submit at the end of 1998 its first regular reports on each candidate’s progress towards accession...”

The present report is a response to the European Council request.

The Commission submitted an opinion on Cyprus to the Council in July 1993. It stated that, “in regard to economic aspects, the adoption of the *acquis communautaire* would pose no insurmountable problems”. The opinion also stated “there would be a greater chance of narrowing the development gap between north and south in the event of Cyprus’s integration with the Community.”

The European Council repeatedly stated, notably at Dublin in December 1996, that negotiations on the accession of Cyprus would begin six months after the conclusion of the Inter-Governmental Conference (IGC) which resulted in the signing of the Treaty of Amsterdam on 2 October 1997.

In Agenda 2000, in 1997, the Commission stressed that while Cyprus would surely not encounter major problems in embracing the *acquis communautaire*, it would have to improve the alignment of its financial rules and practices with those of the European Union (EU), and ensure that cooperation and supervision in all areas of justice and home affairs were stepped up.

It was also noted that the Commission’s 1993 observations as to the economic stagnation in the northern part of the island remained valid, despite substantial financial transfers from Turkey, and in contrast to the remarkable economic development of the southern part.

Agenda 2000 further noted that despite efforts by the United Nations (UN) to settle the Cyprus question, no progress had been made since its 1993 opinion. It reiterated that “the Union is determined to play a positive role in bringing about a just and lasting settlement in accordance with the relevant United Nations Resolutions. The status quo which is at odds with international law, threatens the stability of the island, the region and has implications for security.”

The Luxembourg European Council in December 1997 took the decisions necessary to set the enlargement process in motion. It “decided to convene bilateral intergovernmental conferences in the spring of 1998 to begin negotiations with Cyprus, Hungary, Poland, Estonia, the Czech Republic and Slovenia on the conditions for their entry into the Union and the ensuing Treaty adjustments.”

In addition, the Luxembourg European Council stated that “the accession of Cyprus should benefit all communities and help to bring about civil peace and reconciliation. The accession negotiations will contribute positively to the search for a political solution to the Cyprus problem through the talks under the aegis of the United Nations

which must continue with a view to creating a bi-communal, bi-zonal federation. In this context, the European Council requested that the willingness of the Government of Cyprus to include representatives of the Turkish Cypriot community in the accession negotiating delegation be acted upon”.

On 12 March 1998, Cyprus attended the first meeting of the European Conference in London. On that occasion the President of the Republic of Cyprus Clerides tabled a proposal inviting Turkish Cypriot representatives to participate in the accession negotiations. The Turkish Cypriot leadership has so far not taken up this offer, which remains on the table.

At the ministerial meeting to open accession negotiations with Cyprus on 31 March 1998, the EU Presidency stressed that the accession of Cyprus to the EU should benefit all communities, including the Turkish Cypriot community, and contribute to peace and reconciliation on the island.

Following this opening Conference on accession negotiations, the analytical examination (“screening”) of the *acquis* started with Cyprus on 27 April 1998. Of the 31 chapters, 16 have already been screened. The Cypriot Government has presented its negotiating positions for 7 chapters (related respectively to Industrial Policy -chapter 15-, Small and Medium-Sized Enterprises -chapter 16-, Science and Research -chapter 17-, Education and Training -chapter 18-, Telecom and Information technologies -chapter 19-, Culture and Audiovisual Policy -chapter 20-, Common Foreign and Security Policy -chapter 27-) which have been transmitted to the Council.

The General Affairs Council on 5 October 1998 in Luxembourg took “note of the position papers presented by the six candidate States concerned. It also noted the input provided by the Commission to assist the Union in defining a common position respectively in each bilateral Conference on Accession.”

“The Council requested the convening of meetings of the Conferences on Accession at Ministerial level on 10 November 1998 and at the level of Deputies prior to that meeting in order to have substantive negotiations with Cyprus, Hungary, Poland, Estonia, the Czech Republic and Slovenia...”

b) Methodology

In drafting this report, the Commission drew on information regarding conditions in Cyprus supplied by missions on the spot and by the authorities of the Republic of Cyprus, with whom it maintains close contacts. The sections on the *acquis* incorporate the results of the screening exercise conducted since 27 April 1998 and the report submitted by the Government of the Republic of Cyprus in September 1998. The bar on contacts with Commission representatives imposed by the Turkish Cypriot authorities prevented it from obtaining information on the northern part of the island. Relevant information was provided by the Government of the Republic of Cyprus and international sources such as the United Nations Forces in Cyprus (UNFICYP). This data would need to be reviewed at a later date.

c) Bilateral relations between the EU and Cyprus

c.1 The Association Agreement

Cyprus and the European Community have been linked since 1973 by an Association Agreement which provided for the establishment of a customs union in two stages and within a period of ten years. After successive extensions of the first stage, a Protocol concerning the second stage of the Agreement was signed in Luxembourg on 19 October 1987. In accordance with the provisions of this Protocol, the final phase for the completion of the customs union, likewise in two phases, entered into force on 1 January 1988.

The first phase provides for

- i) the reduction by Cyprus of customs duties and quantitative restrictions on industrial products (with a few exceptions) and on the 43 agricultural products covered by the agreement;
- ii) the adoption of the Common Customs Tariff (CCT) by Cyprus;
- iii) the harmonisation of accompanying policies: competition, state aids, approximation of laws.

It has been implemented satisfactorily and, as from 1.1.1998, Cyprus has (a) abolished all customs duties on manufactured products originating in the Community and referred to in the Protocol, (b) abolished all quantitative restrictions and (c) fully aligned its customs tariff to the CCT in respect of manufactured products originating in third countries.

The second phase provides for the free and unrestricted movement of industrial and agricultural products and the adoption of the accompanying policies required for the completion of the customs union.

No major problems are expected in completing the customs union in 2002 as agreed¹.

The institutions established by the Association Agreement, notably the Association Council, are functioning smoothly. In the context of Cyprus' preparation for membership, they have been complemented by the structured dialogue and subsequently by the accession negotiations process.

c.2 Financial cooperation

Cyprus has received a total of ECU 136 million (including EIB loans and risk capital) under three successive financial protocols extending from 1977 to 1994.

All of it has been committed, except for that part set aside for the Turkish Cypriot community; there have always been serious obstacles to implementing bi-communal

¹ Note however ECJ case C-432/92, Anastasiou, ECR 1994, I - p.3087

projects, resulting in the paralysis of operations intended to bring the two communities closer together.

A fourth Financial Protocol worth ECU 74 million was signed on 30 October 1995, consisting of ECU 50 million in EIB loans, ECU 22 million in grants and ECU 2 million in risk capital.

Out of ECU 22 million in grant aid, ECU 5 million earmarked to help the Cyprus Government prepare for accession (incorporating the *acquis* into Cypriot law and enabling Cypriot organisations to participate in certain Community programmes) have already been allocated.

A further ECU 5 million was allocated to bi-communal projects. The decision by the leader of the Turkish Cypriot community, Mr Denktash, to suspend bi-communal contacts on 26 December 1997 in response to the Luxembourg European Council conclusions has made it virtually impossible to commit any of this.

The remaining ECU 12 million are to finance studies and support operations contributing to a political settlement of the Cyprus question. The Cyprus Government has put forward ideas for action, but the breakdown in sporadic contacts between the two communities has prevented them from being implemented.

ECU 17 million therefore remain to be committed by the end of the year, since the fourth financial protocol expires on 31 December 1998; at the request of the Cyprus Government, a procedure to extend it until 31 December 1999 has been started.

In this context, the question arises as to whether part of the money should be reallocated to stepping up the pre-accession strategy for Cyprus, since the commitment appropriations earmarked for this purpose in the indicative programme adopted on 26 September 1996 have already been used up, while the needs in this area continue to grow, particularly with regard to extending the TAIEX scheme and twinning programme to Cyprus.

c.3 A specific EU pre-accession strategy

The Luxembourg European Council decided on a specific pre-accession strategy for Cyprus based on its participation in certain targeted projects, in particular to boost judicial and administrative capacity and projects in the fields of justice and home affairs and on its participation in certain Community programmes and agencies and the use of technical assistance provided by TAIEX.

Cyprus is already participating in three community programmes: Leonardo, Socrates and Youth for Europe. It has benefited recently from technical assistance provided by TAIEX to help in improving its capacity to apply the *acquis*.

In this context, and despite the fact that the participation in the programmes are open to them, no representatives of the Turkish Cypriot community have so far taken part in the accession process due to the negative attitude taken by the Turkish Cypriot leader.

1. RECENT POLITICAL DEVELOPMENTS

1.1 Institutions in Cyprus

Under the Constitution, there was to be a Greek Cypriot President and a Turkish Cypriot Vice-President, each elected by its own community. The Council of Ministers was to be divided 7:3 between Greek and Turkish Cypriots. The fundamentals of these provisions still apply but without the power sharing element.

There is a strict separation of power between the Executive and the Legislature. Members of the executive Council of Ministers may not be Members of the House of Representatives.

In general, the powers of the respective arms of government are respected, but there have been times when the executive has shown disregard for other organs of government and there are allegations of patronage and small scale corruption.

The institutions of the Republic of Cyprus, in the area controlled by its government, function smoothly.

Political pluralism and election process

There are five political parties represented in the 56 seat House of Representatives and two independent MPs. In addition, there are two parties not represented in Parliament.

Elections are held at three levels: Presidential, Parliamentary and Municipal. The President is elected by universal suffrage by simple majority every five years, usually in two rounds. The elections for the House of Representatives are by proportional representation.

Elections have taken place in free, and peaceful conditions in recent years. On 15 February 1998, the incumbent President Clerides (Conservative party) won a narrow victory in the second round of the presidential elections securing 50.82% to Mr. Iacovou's 49.18%

Institutions of Government

The executive's institutions function smoothly; the public administration is well-structured even if the government is keen to reform it and to improve its efficiency. The post of a Commissioner for the Administration – Ombudsman – was created in January 1991. He has received and investigated a significant number of complaints and the Government has responded positively to most cases.

The civil service numbers 35,615 employees, 12.5% of the 285,000 strong working population. The broader public sector, which includes some service organisations and

local authorities, stands at 47,745 (16,1%). Some sectors of the civil service remain slow and underperforming. Salaries are high compared to the private sector particularly when taking into account the working hours.

There are frequent allegations of corruption and patronage in the civil service. Such complaints have often been upheld by the Ombudsman.

Judicial system

The judiciary is independent. It is headed by the Supreme Court which adjudicates on all matters of the constitutionality of legislation raised by the President, or arising from judicial proceedings or following decisions of the House of Representatives. The Supreme Court has jurisdiction to hear and determine appeals in civil and criminal cases.

Judges are generally of high quality and their integrity is high. The Court system can be extremely slow but otherwise works well. Lawyers are plentiful and accessible in Cyprus, well trained and experienced. However, there is no legal aid scheme as such.

Human rights and respect for and protection of minorities

The EU during the 52nd Session of the Commission on Human Rights in Geneva on 18 March – 26 April 1996, stated that “the status quo has a direct negative impact on the enjoyment of human rights. The division of the island is not acceptable and causes suffering to the population (...). We call for full respect of all human rights and fundamental freedoms of all Cypriots.”

The implementation of obligations taken up in the frame of the UN, the OSCE and the Council of Europe in the field of Human Rights, especially the process of transposition of commitments into national law, remains slow but the process seems to be on track. There are no major problems regarding the observation of fundamental rights and freedoms. Where discrepancies exist the authorities seem determined to rectify them and the necessary procedures have been put in place. In this sense, the prospect of and broad support for EU membership have become a strong impetus to consolidate the process.

Though the death penalty has in essence been invalidated, it is still provided for under the Criminal Code for crimes of treason against the State. Cyprus is expected to abolish the relevant provisions before the end of 1998 and to proceed with the signing of the Council of Europe 6th additional Protocol to the European Convention on Human Rights.

Freedom of expression, association, economic and social rights, and protection of minorities are fully guaranteed and respected. However, as a result of the *de facto* division of the island, fundamental freedoms, in particular the freedom of movement of people in their own country as well as the movement of goods, services and capital, and the right of establishment cannot be exercised over the entire territory of the Republic².

² Note however ECJ case C-363/93, Lancry and others, ECR 1994, I - p. 3957

The situation in the northern part of the island

The situation in the northern part of the island remains unchanged since the 1993 opinion. Mr. Denktash was re-elected "President" in 1995 in the framework of the "Constitution" adopted by referendum in 1975 and modified in 1985, after the unilateral declaration of independence on 15 November 1983 of the "Turkish Republic of Northern Cyprus" ("TRNC"). He holds a large majority in "Parliament". Legislative power rests with the "TRNC Assembly" consisting of 50 "MPs". Seats in the Assembly are contested every 5 years with the next elections taking place in December 1998. His party was successful in the last municipal elections in June 1998. His uncompromising pro-Turkish stance is not entirely shared by the opposition parties which have a more moderate approach towards many issues of substance. For example, they do not support Mr. Denktash's proposal for a confederation and have confirmed their support for a bi-communal and bi-zonal federation.

The Turkish Cypriot population is strongly effected by emigration, yet the total population of the north-eastern part of the island is growing rapidly as a result of the immigration of large numbers of "settlers" from Anatolia; according to UN figures there are now almost 110 000 of them, as against 89 000 Turkish Cypriots, plus some 35 000 Turkish troops. As the Commission emphasised in its 1993 opinion, this situation prevents the indigenous Turkish Cypriot inhabitants from fully exercising their economic and political rights.

The human rights situation in the northern part of the island is extremely worrying, especially the treatment of the remaining 500 elderly Greek Cypriots and of the 100 Maronites (cf: Resolution 1113 of the Council of Europe and various resolutions of the European Parliament). Reports exist of disappearances and extra-judicial killings. A journalist of one newspaper was murdered in 1996. The newspaper claims that this was for speaking out against Turkish policy.

The European Court of Human Rights has ordered Turkey to pay compensation to a Greek Cypriot refugee for barring her access to her property in the northern part of the island. In a ruling, dated 28 July 1998, the Council of Europe's judicial body ordered that Turkey pay 300,000 Cyprus pounds (\$574,500) for depriving the refugee of her ownership rights, 20,000 pounds in personal damages and 137,000 in legal fees. In its judgement, the Court found that the Turkish army "exercised effective overall control" in northern Cyprus. It rejected the Turkish government's position that it did not exercise jurisdiction there.

There is no evidence of political interference or corruption within the judicial system. In addition, a two-tier military Court System also exists; the Court consists of a panel of 3 judges, two from the local judiciary and the third from the resident Turkish mainland forces.

The Turkish Cypriot civil administration does not seem to be prepared to adopt the *acquis*.

1.2 Attempts to settle the Cyprus question

Review of the problem

Since 1963-1964, the “Cyprus question” has been on the agenda of the United Nations.

The existence of the Greek Cypriot and Turkish Cypriot communities living 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 supporters of union (Enosis) with Greece. Turkey responded by intervening militarily. The outcome of the crisis of August 1974 and the occupation by part of the territory of the Republic 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.

On 1st November 1974, the UN General Assembly adopted Resolution 3212 which urged “the speedy withdrawal of all foreign armed forces and foreign military presence and personnel from the Republic of Cyprus and the cessation of all foreign interference in its affairs”. The terms of this resolution have been repeated in numerous resolutions since then.

This *de facto* separation of the two communities, Turkish Cypriot in the northern part and Greek Cypriot in the southern part, has continued. The northern part of the island, as currently divided, represents 37% of the total area.

The development of the conflict since the Turkish occupation of August 1974

Since the 1974 occupation, with very rare exceptions, neither people nor goods nor services can cross the green line that divides the island. In the Republic, whose authority extends in practice only to the south of the island, the Constitution of 1960 is still applied, although all provisions relating to the participation of the Turkish Cypriot community in the exercise of executive, legislative and judicial powers have been suspended since the intercommunal crisis of 1963.

The United Nations Force UNFICYP (1 226 strong in April 1998) has occupied the cease-fire line since 1964; its mandate has been extended by the Security Council every six months.

As a guarantor, Turkey maintained a force of 650 men on the island prior to its intervention of July/August 1974, under Additional Protocol No 1 to the 1960 Treaty of Alliance.

Since 1974 there has been a large Turkish mainland force in northern Cyprus. Current estimates put the number at around 35.000. The force is commanded by a General who reports directly to the Chiefs of Staff in Ankara. The Turkish Cypriot security force is small (4,500 troops, although the Cyprus Constitution’s Article 129 provided for a Cypriot army of 2,000 men of whom 60% would be Greek Cypriot and 40% Turkish Cypriot). It consists almost entirely of conscripts and is deployed largely to guard the areas of the buffer zone in and around Nicosia. The force is commanded by

a Turkish mainland Brigadier who reports directly to the commander of the resident Turkish mainland forces.

Despite numerous UN resolutions, all based on Resolution 3212, calling for the withdrawal of foreign troops from the Republic of Cyprus, Turkey has maintained its forces on the island.

As guarantor, and in application of additional Protocol n°1 already cited above, Greece is allowed to maintain 950 Greek officers, non-commissioned officers and men. Nowadays, it maintains a contingent (known as ELDYK) of about 2,000 in the south to provide for the training of the army of the Republic of Cyprus.

The Greek Cypriot National Guard, consisting of 19,500 men plus a reserve force of 100,000, is commanded by a Greek mainlander and most of the senior officers are also mainland Greek.

The United Kingdom also has 3,500 troops stationed at two military bases under its sovereignty in the south of the island (Article 227(5)(b) of the EU Treaty).

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.

In January 1997 the Government of the Republic of Cyprus placed an order for the purchase of Russian S300 SAM missiles. The delivery of these missiles has been delayed on a number of occasions, most recently until spring 1999. Serious concerns have been expressed, including by a large number of EU Member States, regarding the consequences of the possible deployment of the missiles on the search for a peaceful solution to the Cypriot question.

1.3 The basis for a settlement

Negotiations concerning the search for a solution to the Cyprus problem have been going on intermittently since 1975 under the auspices of the United Nations, but it has not yet been possible to reach an agreement.

The efforts deployed by the UN Secretary-General (and his Special Representative) have been supported on a bilateral level by Special Representatives appointed respectively by the USA, the United Kingdom, Germany, Sweden, Finland, France, Canada, Australia and Russia.

Several EU Presidencies have also appointed a Special Representative to Cyprus. Sir David Hannay, who occupied the position during the British Presidency, has stayed on at the request of the current Austrian Presidency.

The basis for the solution of the Cyprus problem was agreed in two High Level Agreements between President Makarios and Mr. Denktash in February 1977 and

between President Kyprianou and Mr. Denktash in May 1979. The 1977 High Level Agreement set the guidelines for the negotiations stating that the aim was the establishment of an independent, non-aligned and bi-communal federal republic, with the powers and functions of the central federal government being such as to safeguard the unity of the country having regard to its bi-communal character. The 1979 High Level Agreement went further by including respect for the human rights and fundamental freedoms of all citizens, the demilitarization of the island and adequate guarantees for the independence, sovereignty and territorial integrity of the Republic.

Many rounds of talks under UN auspices have followed with no concrete result.

In May 1993, just prior to the publication of the Commission's opinion on Cyprus, UN Secretary General Boutros Ghali met President Clerides and Turkish Cypriot leader Mr. Denktash and called for the resumption of talks.

Despite all the efforts undertaken by the UNSG, notwithstanding an initial encouraging attitude by President Clerides, all the proposals were finally rejected by both leaders.

UNSC Resolution 930/94 called for a far-reaching reflection of effective ways of approaching the Cyprus problem and reiterated the basis for a settlement – single sovereignty, citizenship, international personality, politically equal communities in a bi-zonal, bi-communal federation.

Despite all the UN's efforts to bring the two sides closer, backed by the members of the Security Council, no substantial progress was made, even when the leaders of the two communities met for talks in Troutbeck (New York) in July 1997.

The follow-up in Glion-sur-Montreux in August 1997 failed to live up to expectations.

Since then, the leaders of the two communities have not been able to agree on renewing the dialogue to find an equitable political solution to the problem.

On 31 August 1998 the Turkish Cypriot leader proposed to the Greek Cypriots to establish a confederation to resolve the longstanding conflict on the divided island with the prior acknowledgement or recognition of two equal states; the proposed confederation would be a "partnership settlement" that would also entrench the special relationship between Greek Cypriots and Greece and between Turkish Cypriots and Turkey; the proposal includes Cyprus' accession to the EU.

This initiative has not changed the UNs approach; following separate talks in New York with the leaders of the two communities, coinciding with the UN General Assembly, the Secretary General, Mr Kofi Annan, asked his representative in Cyprus, Dame Ann Hercus, to make every effort to bring the two sides closer with a view to establishing a bi-communal, bi-zonal federation on the island.

In the conclusions of the Luxembourg and Cardiff European Councils, and most recently at the General Affairs Council in Luxembourg on 5 October, the EU expressed its concern at the impasse, noting that "because of the political situation the

Commission's analytical examination of the "acquis" (screening) could not cover Cyprus as a whole and that the invitation of the Cyprus government to include representatives of the Turkish Cypriot community in the negotiations had so far not been taken up. It regretted that it had not been possible to achieve a political solution to the continuing division of Cyprus in time for the accession negotiations."

The General Affairs Council in Luxembourg also reiterated that the "objective (of the EU) remains a bi-communal, bi-zonal federation on the basis of a comprehensive political settlement in accordance with UN Security Council Resolutions. A political settlement would allow the provisions of the Accession treaty to be implemented throughout the island. Progress towards accession and towards a just and viable solution to the Cyprus problem will naturally reinforce each other. The Union reaffirms its full support for the search for a solution under the aegis of the UN."

Mr Denktash, who regards the accession negotiations as only involving the Greek Cypriots, has refused to meet EU and particularly Commission representatives since mid-December 1997, although he continues to have contacts with the special representatives of certain EU Member States.

2. ECONOMIC ISSUES

2.1 Introduction

The 1993 Opinion on the application of the Republic of Cyprus for membership concluded that in regard to economic aspects the adoption of the *acquis* would not pose insurmountable problems. The opinion stated that “the economy of the southern part of the island has demonstrated an ability to adapt and seems ready to face 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”. The Opinion also noted that “liberalising capital movements will require a fundamental reform of the financial and monetary system and of procedures for credit and currency regulation.” This section presents a brief description of developments since the Opinion.

The political division of Cyprus continues to be reflected in the differentiation between the economic structures and the economic performance of the northern and the southern part of the island. The northern part is less populated (200000 inhabitants, of which 89000 are Turkish Cypriots, compared to 660000 inhabitants in the southern part). Per capita income is also significantly lower, around one third of that in the south. The northern part remains highly dependent on Turkey, from which it receives substantial financial support and is its main trading partner. An important share of its trade goes through Turkey to third countries. In spite of the existence of a separate Central Bank the Turkish Lira is the currency circulating in the northern part of Cyprus with consequences for monetary stability.

Due to the absence of reliable data for the northern part of Cyprus, this section focuses only on the southern part.

2.2 Economic Developments since the Commission opinion

Macroeconomic developments

Since 1993 Cyprus has continued to open its economy and pursue structural reforms, although advances in the liberalisation of some areas of the economy, for example in the financial sector, have been slow. Per capita income is high, in particular in comparison to other candidate countries and higher than in certain Member States. The tertiary sector has continued to expand: its share in gross value added is now approximately 70% and it employs about 65% of the gainfully employed population. In 1997 the manufacturing sector contributed to 11.8% of GDP, down from 13.5% in 1993. Traditional sectors, such as textiles and leather, have suffered from a loss of competitiveness. In contrast, activity has expanded in non-traditional sectors, such as chemicals and plastic products. Financial services have continued to expand rapidly, in part as a result of growing offshore activity, which covers a wide range of financial and commercial services. Offshore activities produce gross foreign exchange revenue equivalent to approximately 3.9% of GDP, employ 1.7% of the total employed population and generate 2.4% of total tax revenue in corporate and other direct taxes.³

³ The stated business purpose of a significant number of these companies is to offer advice on and/or deal in Russian and CIS securities. Offshore trade companies

The sector's development is heavily dependent not only on Cyprus' comparative advantages (strategic geographic location, educated workforce and advanced infrastructure), but also on the existence of very favourable fiscal conditions. The regulatory framework of the financial offshore sector has been reinforced with the adoption of the law on the Prevention and Suppression of Money Laundering Activities in 1996.

Macroeconomic developments during 1993-1997 have been somewhat mixed. On the one hand, unemployment has remained very low, inflation has gradually declined, and progress has been made on domestic competition policy, removing controls on prices and liberalising external trade policy. On the other hand, owing in part to adverse developments in the tourism and agriculture sectors, economic growth has declined and financial imbalances, partly policy induced, have emerged. The fiscal and current account deficits widened considerably in 1997-98.

The Government has recently approved the broad lines of the next five-year Strategic Development Plan (1999-2003), whose objectives are an annual growth rate of around 4% and inflation of 2.5%. This is to be based on a sustainable fiscal position and continued improvement on the supply side through accelerated structural reforms, in particular in the financial sector.

Real GDP grew on average 4.4% a year in the early 1990s, but slowed to little over 2% per annum in 1996-1997. Since the early 1990s, the vagaries of the large tourism sector and fluctuations in the agricultural sector (drought for 3 years) have also caused a marked increase in the volatility of economic growth.

Despite the decline in economic growth, Cyprus has continued to enjoy near full employment. The unemployment rate increased only slightly from 2.7% in 1993 to 3.4% in 1997, while the gainfully employed population increased by 7% from 265,300 to 285,300. This performance has been underpinned by consensus-building policies between unions and employers associations, few hiring and firing restrictions and relatively low and short unemployment benefits. But , the system for setting wages has remained relatively rigid and highly centralised, with widespread indexation.

Cyprus has successfully maintained the exchange rate peg to the ECU⁴, in particular through the convergence of price inflation towards the average performance in the EU. Inflation declined fairly steadily from 4.9% in 1993 to 2.5% in May 1998. While the conduct of monetary policy shifted in early 1996 from direct to indirect market-based instruments (repurchase and reverse repurchase transactions), its effectiveness is still affected by a number of restrictions which remain in the financial system, including the legal interest rate ceiling of 9% on all lending operations and the fact that the co-operative credit sector still remains outside the supervision of the Central Bank (see below).

also have strong commercial links with Central and Eastern Europe, as well as the Middle East.

⁴ The Cyprus pound has been pegged to the ECU since 1992 with a central rate of 1.7086 and fluctuation of +/-2.25%. The authorities plan to shift their peg to the euro next year.

Successful budget consolidation took place during 1993-95. As a result of the combination of strong revenue collection after the introduction of VAT in 1992 and the containment of expenditure, the Government's budget was gradually reduced from 2.4% of GDP in 1993 to 1% of GDP in 1995. This downward trend was interrupted in 1996 when the authorities decided to respond to the economic slowdown through the adoption of counter-cyclical expansionary fiscal policies. The deficit increased to 3.4% of GDP in 1996 and further increased to 5.1% of GDP in 1997 due to higher public expenditure, notably on defence outlays, social pension benefits, and wages and salaries. The 1998 budget law aims to stabilise the deficit at 5% of GDP. However, the Government decided in mid-1998 to submit to Parliament a corrective fiscal package, due mainly to higher expenditure, as well as a slight reduction in revenue collection (because of lower customs revenues as a result of the adoption on 1 January 1998 of the EU Common Customs Tariff in the context of the Customs Union Agreement).

The public debt-to-GDP ratio has increased by about 4 percentage points since 1995 to reach 55.6% at end-1997. 87% of total gross public debt is domestic, approximately 80% of this is short-term. Since 1996 debt management techniques have improved, with the introduction of Treasury bill auctions and bonds of maturities between 3 months and 10 years.

Cyprus' current account shifted from a balanced position on average in the period 1993-95 to a deficit of 5% of GDP in 1996-97. This deterioration was in part due to expansionary aggregate demand policies, in particular the spill-over to the external account of the 1996-97 expansionary fiscal policy, and in part to the sharp decline of tourism receipts in 1996. It also reflected the negative trends in competitiveness and export market share since the early 1990s. The deficits were financed by recourse to international capital markets. Despite this external deterioration, Cyprus's debt indicators remained low. At end-1997, public and private external debt stood respectively at 21% and 9.5% of GDP. Gross foreign exchange reserves remained at a level equivalent to 5.4 months of imports at the end of 1997.

Since the early 1980s, trade in goods and services has represented over 100% of Cyprus' GDP. Due to its small manufacturing base, the country has a structural trade deficit. Since 1992, Cyprus has become increasingly a transit or processing centre, as re-exports have overtaken domestic exports. The EU is Cyprus' most important trading partner, despite the fact that the percentage of total exports absorbed by EU markets has fallen considerably since the beginning of the decade. In 1997 exports to the EU-15 were 47.9% of the total, compared to 55.3 % in 1993. When re-exports are included, the respective figures are 27 % and 37.4%. During 1993-97 imports from the EU contracted slightly from almost 52% to 47.6% of total imports. During the same period, eastern and central European markets have grown in importance, absorbing 27.4% of Cyprus' exports (including re-exports) in 1997, compared to 11.4% in 1993. The EU's share in total re-exports is 16%, while Russia and Bulgaria's share together is 40%.

There are no major trade problems between Cyprus and the EU.

Structural issues

In the context of its Customs Union Agreement with the EU Cyprus has made strong

progress in trade liberalisation. Its capital account remains relatively restricted, although some capital account operations were recently liberalised. Direct investment, real estate investment, portfolio transactions, financial credits and the opening of deposits abroad are only partly free. In 1996-97 steps were taken to liberalise certain transactions on outward foreign investment by companies listed on the Cyprus Stock Exchange⁵ and on inward portfolio investment by non-residents in listed companies and banks. In 1997 the level of inward foreign direct investment (FDI) permitted in manufacturing, trade, and services was increased from 49% to 100%. Under the new policy, the administrative procedures for FDI were simplified. Foreign participation of up to 100% is now permitted in most sectors of the economy, with the exception of land development, education, and public utilities. Foreign participation in financial services, oil refining, tourism and trading depends on case by case decisions by the authorities. Cyprus is thus still a long way from adopting the *acquis* on capital movements.

Capital account liberalisation will introduce competition into Cyprus' protected domestic commercial banking sector and it will consequently have to go hand in hand with an extensive adjustment of the Cypriot financial system. A prerequisite for this will be the abolition of the interest rate ceiling, which in particular prevents *domestic commercial banks* from charging more than 9% interest rate on loans and has favoured the allocation of credit to low-risk activities. The Central Bank can also prescribe maximum deposit and lending rates below the 9% ceiling. The authorities plan to abolish these restrictions by the end of 1998. Operating alongside the commercial banks, Cyprus' *credit co-operatives*, which hold over 32% of total deposits and whose assets represent about 50% of GDP, constitute a weak segment in the financial system and will represent a source of risk when the sector is liberalised. The co-operative credit sector is not regulated under the new 1997 Banking Law and remains subject to less stringent prudential standards, outside the supervisory purview of the Central Bank. The level of non-performing loans of the credit co-operatives may be two or three times larger than that of the commercial banks.⁶

2.3 General Evaluation

Developments since 1993 confirm that the Cyprus economy possesses the ability to adapt to the challenges posed by the adoption of the *acquis* and that the authorities appear committed to restoring a stable macroeconomic environment and a favourable business climate. As a result of the characteristics of the country, notably its insularity and the continuous wage pressures and wage rigidity (also related to the full employment situation), Cyprus has in recent years lost competitiveness in traditional sectors (industry and tourism). This is also reflected in the declining trend of domestic

⁵ The official *stock exchange* started operating in 1996 and listed 47 companies at the end of 1997. Strict capital account regulations have shielded it from global instability, but they have contributed to determine the absence of serious foreign investors.

⁶ The level of non-performing loans in the portfolio of commercial banks was 4.8% in 1997 (up from 4% in 1995 as a result of the economic slowdown).

exports to the EU. But the importance of the tertiary sector has continued to increase, while efforts have been made to reduce the overdependence of the economy on tourism. This trend can be expected to continue. The most notable development has been the large and growing importance of the international business sector, in particular the offshore banking sector. It will be important to ensure that the sector's activities are in line with the acquis. Another equally important challenge will be to restructure the domestic financial sector with a view to ensuring that it can withstand competition stemming from capital account liberalisation.

The integration of the northern part of Cyprus, especially if taking place in the context of Cyprus accession to the EU, will not raise major economic difficulties, because of its relatively small size and its potential, in particular, in terms of agriculture and tourism. However, it will be important to bring the basic infrastructure up to the standard of the southern part of the island.

3. PROGRESS IN ADOPTING THE ACQUIS

The 1993 Commission opinion stated that the adoption of the acquis would not appear to present insurmountable problems in the case of Cyprus. Due to the fact that a large number of the instruments required for the progressive adaptation were already contained in the Association Agreement and the 1987 Protocol, the proper implementation of these instruments was considered the best means of ensuring a smooth passage for the Cyprus economy towards possible accession. Assuming continued work on reforms in this regard, the southern part of the island seemed ready to face the challenge of integration.

Since the 1993 Commission opinion, Cyprus has made significant progress in many areas of the acquis. Most notably, Cyprus entered into a Customs Union with the European Community on 1 January 1998 as foreseen under the Association Agreement and its 1987 Protocol.

The Commission opinion underlined that there would be a greater chance of narrowing the development gap between the northern and southern part of the island in the event of Cyprus's integration with the Community. Although President Clerides invited representatives of the Turkish Cypriot community to participate in the accession negotiations, this offer has so far not been taken up. Information on progress in adopting the acquis therefore remains limited to the southern part of the island.

In February 1998, the Cypriot authorities and the Commission held technical meetings to clarify progress made by the Cypriot authorities on certain sectors of the acquis. In April 1998 they entered into an exercise of screening Cypriot legislation and enforcement structures to examine their compatibility with the acquis in 16 fields.

Sector by sector, this section examines in detail progress since the Commission opinion of 1993. This includes an assessment of the progress made in the alignment of legislation with the acquis as well as of capacity to apply the acquis. The European Council in Madrid in December 1995 referred to the need to create conditions for the gradual, harmonious integration of the candidates, particularly through the adjustment of their administrative structures. It is important to incorporate Community legislation into national legislation effectively, but even more important to implement it properly in the field, via the appropriate administrative and judicial structures. This is an essential pre-condition for creating the mutual trust indispensable for future membership.

3.1 Internal Market without frontiers

The EU's internal market is defined in Article 7a of the Treaty as an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured. This internal market, central to the integration process, is based on an open-market economy in which competition and economic and social cohesion must play a full part.

Effective implementation and enforcement of these four freedoms requires not only compliance with such important principles as, for example, non discrimination or

mutual recognition of national legislations but also the effective application of common rules, such as those designed for safety, environmental or consumer protection, and effective means of redress. The same principles apply to certain common rules, for example in the areas of public procurement, intellectual property and data protection, which are important in shaping the general framework within which economies operate.

The Four Freedoms

In the framework of the entry into force of the EC-Cyprus Customs Union, the Association Agreement between the Community and Cyprus provides for the abolition of customs duties and the harmonisation of accompanying policies, including the harmonisation of legislation. These measures represent the first steps toward harmonisation in the field of free movement of goods. Further to the provisions of the Association Agreement, Cyprus will have to implement all the *acquis* throughout the four freedoms and their corresponding general framework.

General Framework

Cyprus reformed its public procurement legislation in 1997. It is oriented towards the relevant EC directives although, at present, only partial transposition has been achieved. In this regard, further harmonisation will be needed with respect to, among other issues, publication, time limits for the receipt of tenders, review bodies, and some administrative regulations. Certain provisions of the law will need to be extended to local authorities and bodies governed by public law. The regime applicable to utilities, as understood in European Community law, should be clarified, and eventually harmonised with that of the European Community. Cypriot law provides for the possibility of granting preferential treatment in favour of local production under certain circumstances, which is incompatible with European Community rules.

Cyprus has a well-functioning remedies system although further alignment efforts are needed. Interim measures are available but not before the award of contract. A specialised Main Tender Board within the administration monitors and supervises procurement procedures. Municipalities follow their own organisational system. Control of the application of the rules is exclusively the responsibility of the courts of justice. The system will need to be adapted and improved in this regard.

As far as industrial and intellectual property is concerned, important progress has been achieved in the field of patents. A new law – including the introduction of the Supplementary Protection Certificate (SPC) for pharmaceutical products - which is fully compatible with TRIPs and European standards entered into force on 1 April 1998. Since that date, Cyprus has also been a party to the Munich convention (of 1973) and the Patent Cooperation Treaty (PCT). Efforts towards approximation are still needed for trade marks. Special attention should be paid to enforcement, including border enforcement. Important progress still needs to be made in the legislative field towards alignment with the *acquis* in the field of copyright and neighbouring rights. Cyprus' ability to ensure adequate enforcement of intellectual property needs to be further monitored. The administrative capacity of Cyprus to ensure full implementation of copyright legislation should be strengthened.

On company law, the current Cypriot law of 1951 has been amended several times with a view to aligning it with the *acquis*. Further approximation is however needed concerning the rules of disclosure of certain data on capital rules of public limited liability companies (2nd Company Law Directive), and on rules setting up single member companies (12th Company Law Directive). Furthermore, some provisions on the 1st, 3rd and 6th Company Law Directives remain to be aligned.

Cyprus follows international accounting standards but still needs to implement the bulk of the Directives' provisions on balance sheets and profit/loss accounts. The approximation of the EU accounting rule for "private exempt companies" and for the off-shore sector is a matter of concern.

Cyprus has signed the Council of Europe's Convention 108 of 25 July 1986 on data protection. Cyprus has not yet adopted any legislation in the field of data protection. Much remains to be done to align its legislation to the *acquis*.

Conclusion

Progress has been made in recent years, in particular, on industrial property. Further efforts are needed in all the above-mentioned fields. Special attention should be paid to enforcement.

Free Movement of Goods

Free Movement of Goods can be achieved only by removing measures which restrict trade, not only customs duties and quantitative restrictions but all measures with equivalent effect. Where technical regulations are not harmonised, free movement of goods must be ensured by applying the principle of mutual recognition of national rules. This principle was established by the *Cassis de Dijon* judgement. For the purpose of harmonisation the European Community has developed the New Approach which, instead of imposing technical solutions, is limited to establishing the essential requirements that products must meet. Nevertheless, some directives follow the traditional regulatory pattern of providing fully detailed rules. This applies to products such as pharmaceuticals, chemicals, motor vehicles and food stuffs. The horizontal directive on liability for defective products also constitutes an essential element for the free circulation of goods.

On 1 January 1997 a new law on Product Liability entered into force. Except for some technical fine-tuning, it conforms with the present EU legislation in this field.

The Cyprus organisation for Standards (CYS) has so far made some progress in transposing EU Standards into Cyprus Standards. CYS is currently an affiliate member of CEN and Cenelec and a full member of ETSI, ISO and IEC. CYS remains to be transformed into an independent standardisation body via a new law on standardisation. The different activities of CYS, namely Standardisation, Certification and Accreditation, should be separated by function.

Cyprus has made uneven progress in the various fields. In the field of legal metrology, the existing legislation is not fully harmonised with the EU Directives. The toys

related legislation has been fully transposed and has been in force since 1 March 1998. In the fields of machines, lifts, construction products, gas appliances, electrical equipment, medical devices and personal protective equipment, the existing legislation does not cover all the requirements of the EU Directives. Similarly, the legislation in the field of Motor Vehicles is not fully compatible with EU Directives.

In the field of foodstuffs, mandatory standards have not been aligned. Problems may arise in the application by the industry of the EU Directives on hygiene requirements.

In the field of chemicals, the implementing regulations on the basis of the Dangerous Substances Law of 1991, as amended in 1997, have not been adopted. In the areas of fertilisers and drug precursors, good progress has been achieved. In the field of pharmaceuticals, the current legislative framework is not fully aligned with EU Directives.

The necessary administrative structures to implement and enforce the *acquis* in these areas need to be strengthened to meet EU requirements.

Free Movement of Capital

The Commission's opinion of 1993 stated that capital movements were strictly regulated. Since then, Cyprus has adopted a gradual liberalisation approach. A series of liberalisation measures have been implemented, notably in the field of direct investment, portfolio transactions and personal capital movements.

Despite the on-going process of liberalisation, restrictions continue to exist on most types of capital movements. Cyprus is therefore still far from adopting the *acquis*. The process of liberalisation is hampered by a statutory limit (at 9%) on domestic interest rates. Financial credits from abroad and the opening of deposits by residents abroad cannot effectively be freed as long as the interest rate limit is not abolished. In view of the fairly stable macroeconomic conditions, the efficient instruments for monetary policy that have been established in recent years and the relatively developed financial system, the abolition of the interest rate ceiling would allow a quick liberalisation of capital movements and further development of the financial system.

Free Movement of Services

The basis of the free movement of services is the prohibition of discrimination, in particular on grounds of nationality. The implementation of the relevant rules implies the existence of administrative structures and greater co-operation between Member States in the area of enforcement (mutual recognition arrangements). A substantial amount of the legislation applicable to the free movement of services relates to financial services.

Prudential regulation has undergone important changes since the 1993 opinion. The Banking Bill was updated in 1997, promoting harmonisation with the EU Directives on banking operations. But the Banking Law is not applied to co-operatives which are therefore not under the authority of the Central Bank and are subject to less stringent prudential standards. Furthermore, approximation is still necessary for the freedom of

establishment and some further legislative measures are yet to be taken concerning, inter alia, deposit guarantee schemes.

Cyprus has not yet adopted any specific legislation to transpose Directives on cross-border credit transfers and on settlement finality in payment and securities settlement systems. The Central Bank has started the preliminary activities for the introduction of a real time gross settlement system.

Cyprus has made progress in aligning its legislation to the securities markets acquis. Gaps remain regarding capital adequacy requirements, free provision of investment services and investor compensation schemes.

The Insurance Sector is comparatively well developed, operating under a tightly controlled regulatory regime. The law regulating insurance matters needs to be further aligned to the acquis.

In the off-shore business, Cyprus does not fully apply the current legislation since the banking law authorises the Central Bank to waive the applicable legislation. Meanwhile, the growing importance of the sector has been one of the most notable developments of recent years. The sector's activities need to be aligned with the acquis.

Regarding the anti-money-laundering legislation, Cyprus has a comprehensive legal framework that meets the requirements of the relevant EU Directive. Some enforcement structures are fairly recent and still need to prove their worth. The allocation of resources to them may not be adequate.

Free Movement of Persons

The free movement of persons encompasses two concepts with different implications in the Treaty. Article 7a in Part One of the Treaty on "Principles" implies that persons are not to be subject to controls when crossing the internal frontiers between Member States. On the other hand, Article 8a in Part Two of the Treaty on Citizenship of the EU gives every citizen of the EU the individual right to move and reside freely within the territory of the Member States, subject to certain conditions. The abolition of frontier checks must apply to all persons, whatever their nationality, if Article 7a is to have effect. The rights deriving from it have not yet been fully applied throughout the EU.

Free movement of Union citizens

In the area of right of residence, the present legislative framework is restrictive as regards the entry, stay and employment of foreign nationals. A sustained effort will be necessary to ensure effective alignment with the acquis. Furthermore there appears to be little regulation in the field of mutual recognition of professional qualifications, with the exception of nationality clauses. In practice, diplomas delivered from EU Member States' universities are usually recognised. A Council for Recognition of Titles of Studies has been set up and is about to start work.

Abolition of checks on persons at internal frontiers

Despite its insularity, Cyprus will have to abolish checks on persons for air and sea transport within the EU. Corresponding mechanisms are not yet in place. Cyprus has requested technical assistance on the issues of external border control, alignment of visa policy and on the SIS system.

Competition

In the antitrust area, Cyprus has introduced extensive legislation since 1989. The basic principles of Community competition law, including a great part of the secondary legislation (block exemptions), have been incorporated in the law. Further improvements are necessary. The swift adoption of provisions on merger control and on the introduction of provisions similar to Article 90 EC Treaty concerning public undertakings and undertakings with exclusive rights is important. Full enforcement of the rules is necessary.

The independence of the Office for the Protection of Competition and its powers of investigation should be strengthened. Further staff and specialized training will be necessary in order to ensure effective competition enforcement.

Cyprus lacks a general legislative framework on State aid. It has a relatively transparent system of reporting and inventory of State aid, but it should be fine-tuned. Some potentially problematic State aid aspects need further examination, notably in the following fields: shipping sector, ports, telecommunications, civil aviation, state aid aspects of offshore, co-operatives. The latter deserve special attention as they are not in line with the *acquis*. An independent State aid monitoring authority should be set up and given the necessary powers to ensure effective State aid control.

Conclusion

Since the 1993 opinion, Cyprus has made progress in the transposition of the *acquis* in parts of the general framework and the fields of free movement of goods, services and capital.

Further efforts to transpose the *acquis* are needed throughout the four freedoms and the general framework. Substantial work remains to be done in the field of free movement of goods. The regime of capital markets has a considerable distance to go to approach the *acquis*.

Special attention will have to be paid to implementation and enforcement structures. Cyprus continues to require technical assistance and advice in order to bring its legislation and administrative structures into line with European Community law.

The fact that the legal provisions for the operation of the important off-shore sector could be incompatible with the *acquis* raises particular concerns. In particular off-shore financial activities do not seem to be entirely compatible with the prevailing banking legislation. This issue may prove to be one of the most difficult questions in the internal market field.

On competition, in the anti-trust area, the legislative situation is generally encouraging. Work is needed on enforcement. Merger control should be established. Rules similar to article 90 must be adopted quickly. In order to ensure effective enforcement of competition rules, efforts should be made to reinforce the Office for the Protection of Competition. Further specialised training will be essential. Monopolized sectors should be adjusted. In the State aid area, the adoption of the legislative framework for State aid needs special attention. Structures for state aid control also need strengthening. Some State aids (notably co-operatives) should be aligned with the *acquis*.

3.2 Customs

Cyprus has effectively implemented the Protocol of 19 October 1987 which involves the elimination of customs duties between Cyprus and the European Community as well as the adoption by Cyprus of the Common Customs Tariff. Since 1 January 1998, all import duties and taxes of equivalent effect have been eliminated on goods referred to in the Protocol. As for the application of the Common Customs Tariff, Cyprus has gradually adjusted duties. Since 1 January 1998, the Common Customs Tariff has been applied in accordance with the Protocol, including for the products referred to in Annex 4 originating from third countries. But a substantial part of the customs legislation remains to be aligned.

Cyprus's institutional capacity to apply the *acquis* presupposes the existence of an adequate level of infrastructure and equipment, in particular in terms of computerisation in order to participate in the various computerised systems necessary for the management of the customs and indirect taxation provisions, as well as computerised systems for mutual assistance. While the Cypriot customs services are not yet up to the required standards, they are undertaking efforts to implement a new system and to train officials. The Single Administrative Document has been implemented with effect from 1 January 1997. Following the authorisation of the Council, negotiations on a Mutual Administrative Assistance Protocol on customs matters are to start soon. Currently, Cyprus is the only candidate country not having concluded such a protocol with the European Community.

Conclusion

Cyprus has made continuous progress since the Commission opinion of July 1993. However, although Cyprus can count on a modern customs administration, it should reinforce its effort to align its customs legislation fully and prepare its customs services for the operation of all the customs procedures with economic impact, the system of tariff suspensions, the administration of tariff quotas and ceilings and the use of a modern computerised system.

3.3 Taxation

On direct taxation, the two company taxation Directives and the arbitration Convention provide for a mechanism which applies on the basis of reciprocity.

Respective provisions can therefore by definition not be expected to exist before accession.

On indirect taxation, the opinion of 1993 stated that the VAT system applied in Cyprus conformed, in the main, to that of the Community. VAT was introduced in Cyprus with effect from 1 July 1992. The VAT legislation has been based on the main principles of the Sixth VAT Directive, but it differs from the acquis in some significant areas such as exempt transactions, the definition of place of supply and the provisions for the right of deduction. As for the latter, the Cypriot legislation does not provide for a refund scheme for foreign taxable persons not established on the island. Furthermore, farmers do not fall under the provisions of the VAT law regarding supplies made by them of goods and services, which consist of agricultural products produced by them or the supply of agricultural services. Cyprus applies a standard VAT rate of 8%, initially set at 5%, to all goods or services unless they are zero rated. The latter is applied to a large number of items, including foodstuffs, water, medicine, books, newspapers, children's clothing, footwear and certain passenger transport. The VAT-system thus has not yet been aligned.

Cyprus currently charges excise duties on a wide range of other products in addition to goods subject to the common Community excise duties. This reliance on revenue from non-Community indirect taxes could cause problems after accession. As regards the European Community excise duties, the most difficult problem is that Cyprus does not currently charge excise duty on mineral oils other than petrol. Additionally, Cyprus has a two-tier system of cigarette taxation, which causes obvious problems with Community law, and its excise duty on spirits falls a long way below the European Community minimum (conversely, imports are currently subject to high rates of customs duty, which must be removed). Cyprus already has a warehousing system, which should be adjusted to fit Community requirements.

Although alignments of Cypriot VAT to that of the European Community have taken place since the 1993 Commission opinion, further progress remains necessary, in particular as regards the application of VAT rates (scope and rate levels), a refund scheme for foreign taxable persons not established in Cyprus and the taxation of farmers. Furthermore, preparations for the European Community's transitional VAT regime should be initiated. Arrangements for administrative co-operation and mutual assistance as well as the administrative capacity of implementation should also be strengthened. In the field of excises some essential problems remain which require significant efforts in order to align Cyprus' excise legislation to that of the European Community. Some of the required alignments could have widespread economic effects.

3.4 Employment, Working conditions and Social Affairs

The 1993 opinion suggested that the accession of Cyprus would not raise major difficulties in the social sphere. It remains the case that the social situation is comparable to that of Member States. The social dialogue between employers and trade unions at various levels is well established and is likely to be able to assume the role habitually played in an EU Member State.

Unemployment remains low compared with the EU average. Employment policy and programmes are designed and adopted within the framework of the Government's Economic Development Plans. One of the basic objectives is to encourage the more productive utilisation of human resources in conditions of full employment.

Cyprus is in the process of aligning its legislation to European labour law, but a number of important provisions in European labour law directives have not yet been transposed.

The main provisions of EU legislation concerning the equal treatment of men and women are covered by national legislation. Equal pay is regulated in national law and collective agreements. Labour Inspectorates monitor enforcement. Equal access to work is guaranteed through the general non-discrimination clause. National tribunals ensure it is respected. However, a Parental Leave provision does not yet exist and rules on the burden of proof do not cover all areas under the scope of the relevant EU directive.

In the area of public health, substantial parts of the "tobacco" Directives on labelling and maximum tar content have been transposed but not yet fully. The new Directive concerning tobacco advertising and sponsorship will also have to be transposed.

Cyprus has embarked on a revision of its legislation on Health and Safety at the Work Place. A Health and Safety at Work law came into force in January 1997 which partly transposes the framework acquis. It sets up new institutions and provides for the progressive revision and updating of all existing health and safety legislation. The Labour Inspectorate is organised and structured in accordance with ILO Convention 81. It employs 40 inspectors and performs an enforcement effort comparable to EU levels.

Conclusion

Parts of the acquis have been transposed in the above-mentioned fields. Further progress is necessary, in particular, as regards Labour Law and Occupational Health and Safety. Cyprus has effective enforcement structures.

3.5 Economic and Monetary Union

When the third stage of EMU has commenced, all Member States, including new ones, will participate in the Economic and Monetary Union, but they will not necessarily be expected to adopt the euro from the start. Their economic policies will be a matter of common concern and it will be involved in the co-ordination of economic policies. Upon accession, Cyprus will be required to respect the stability and growth pact, to renounce any direct central bank financing of the public sector deficit and privileged access of public authorities to financial institutions and to have completed liberalisation of capital movements. Accession means closer monetary and exchange rate co-operation with the European Union. Member States not participating in the euro area will be able to conduct an autonomous monetary policy and participate in the European System of Central Banks (ESCB) on a restricted basis. Their central banks will have to be independent and have price stability as their primary objective.

As membership of the EU includes acceptance of the goal of EMU, the convergence criteria will have to be fulfilled by Cyprus, although not necessarily upon accession. They remain key points of reference for stability oriented macro-economic policies, and must in time be fulfilled by new Member States on a permanent basis.

Cyprus continues to prepare for integration into Economic and Monetary Union.

The Central Bank of Cyprus (CBC) is not independent from the Government. The Bank is governed by a 1963 law which allows for a representative of the Ministry of Finance to sit on the Bank's board and take part in decision making.

Cyprus does not comply with the Treaty on the issue of Central Bank financing, although a ceiling for such financing was set in 1994. Since then, this ceiling has been reduced every year. No information is available on the issue of the privileged access of the Government to financial institutions.

3.6 Regional Policies and Cohesion

The regional disparity between northern and southern part has further increased. In 1960, the per capita revenue of the Turkish Cypriots was estimated at 86% of that of the Greek Cypriots. Today, on the basis of the current exchange rates, the GDP per capita of the northern part constitutes only 30% of that of the southern part. The available data suggests strong disparities throughout almost all sectors. The implementation of the structural funds will address the socio-economic disparities between the northern and the southern parts of the island as well as the establishment of an integrated infrastructure.

In view of the size of the island and its de facto partition, Cyprus does not have a regional policy as such. Since independence, the Cyprus Government has set up a National Development Plan administered by the Planning Bureau and an Island Plan administered by the Town and Country Planning Service. Both are aimed at the harmonious development of all areas of the island. Since 1974, their competence has been limited to the southern part. There is no official information on policy implementation in the northern part. Cyprus is preparing its administrative structures for the possible management of structural funds.

Conclusion

The regional disparities between the northern and southern part of the island have further increased. The implementation of structural funds will have to address these disparities when a political solution is found.

3.7 Industry including SMEs

The Commission opinion of 1993 stated that integration into the European single market would not pose insurmountable difficulties for Cyprus. However, many sectors continue to face significant problems in restructuring. Cyprus' industry has been experiencing erosion of competitiveness for some time as a result of rising labour and other costs, combined with structural weaknesses, such as a shortage of

labour, a lack of domestic raw materials and a small domestic market. These weaknesses handicap industry which faces intensifying competition from low-cost competitors on the one hand and high wage producers, who compete on the basis of quality and design on the other. These problems have become acute in the last few years, leading to negative or very low growth rates, a loss of export markets and the relative decline of employment. The result is particularly serious in the clothing and footwear sectors.

The industrial policy of Cyprus follows a similar approach to that of the EU. In recent years, several steps have been taken towards the harmonisation of industrial policy with the acquis, particularly with regard to the liberalisation of imports in the context of the implementation of the Customs Union Agreement between Cyprus and the European Community.

The current industrial policy of Cyprus is outlined in a Strategic Development Plan for the period 1994-1998. The principles underpinning this plan follow the main orientations of EU policy. The plan is based on the reduction of protection, greater liberalisation and the abolition of export licences and price controls. Due to the industrial structure of Cyprus, special attention is being devoted to policies aimed at small and medium-sized companies. For the manufacturing sector, a significant part of the process of harmonisation has been completed in the context of the implementation of the first phase of the Customs Union, which has transformed the framework in which the industrial sector operates.

As a result of accession, Cyprus industry will be under additional pressure. Giving the industry the means to face up to this challenge will be of vital importance. It is therefore necessary to accelerate the restructuring process and to establish a sustainable and competitive industrial structure.

Meanwhile, Cyprus' economy remains dominated by small enterprises (only 36 enterprises can be classified as large companies, accounting for only 11% of total employment). They share a number of structural weaknesses which the Government intends to overcome by a package of support schemes, including the upgrading of management and staff training. The main aim is to restructure enterprises, improve infrastructures and to strengthen the technological base. According to the available information, Cyprus SME policy seems to conform to EU policy.

Cyprus' participation in the Third Multiannual Programme for SMEs by mid-1999, as soon as the relevant bilateral agreement is adopted.

Although the main principles of Cyprus' industrial policy appear compatible with the EU's industrial competitiveness policy, considerable further progress will be needed in order to restructure industry. It is particularly important that it accelerates the restructuring process and establishes a sustainable and competitive industrial structure.

3.8 Agriculture and Fisheries

Agricultural production accounts for about 5% of GDP, 10% of employment and although Cyprus is a net importer of food, for 20% of exports. The sector's share in

GDP has decreased from 7.2% of GDP since the 1993 opinion. The total work force involved in agriculture expressed in full-time equivalents is 29,000 persons and agricultural land accounts for only 200,000 hectares.

Compared to the situation in 1993, two major developments in agricultural market policy have taken place. The first development derives from the implementation of the GATT Uruguay Round results. Due to the implementation of these results, the formerly existing general system of quotas, or import prohibitions for agricultural commodities, was replaced by tariffs. The corresponding bound rates are similar to those of the EU, in many cases even higher. As regards EU-Cyprus bilateral trade, Community produce enjoys preferential access to the Cypriot market within the framework of the Association Agreement.

The second development concerns the evolution of agricultural market organisations. Traditionally, the markets were strongly regulated and supported. In recent years, Cyprus has already tried to align them to a certain degree to EU market organisation. Examples are the introduction of (small) headage premiums for cattle and sheep, the abolition of administrative prices for pig and poultry, and support for the creation of producer organisations in the fruit and vegetable sector. A reform of the cereal market organisation is currently under discussion, including a certain reduction of support prices which are to be compensated by direct acreage payments.

On the other hand, there persist policy measures which are not yet aligned with the requirements of the Common Agricultural Policy, including the level of support prices for several commodities, input subsidies (feeding stuff and water) and the state- or semi state-controlled trading monopolies. Also, existing institutions need adjusting in order to be able to implement the Common Agricultural Policy.

Cyprus has introduced some measures of structural and environmental policy which are in the spirit of existing EU policies in these areas, such as, a young farmers settlement scheme and an afforestation programme.

Conclusion

In recent years, Cyprus has progressed in preparing the integration of its agriculture and agricultural policies into the Common Agricultural Policy. This process needs to be continued. Given the small size of the Cypriot agricultural sector, Cyprus' accession should not have any major impact on Community markets.

Fisheries

Fisheries is a very small sector of economic activity, contributing only around 4% of the total value added generated in the broader sector of agriculture. It provides direct employment to about 1500 people. Between 1991 and 1996, total fish production increased by 4.5% annually. Total fish consumption is well above domestic fish production. In 1996, domestic fish production was 3364 metric tonnes while 5142 metric tonnes were imported.

Cypriot legislation is being revised in order to align it to the Community legislation. Equally, legislative and technical modifications are being undertaken to ensure the

implementation of the Common Fishery Policy. The alignment of legislation and administrative reforms should not pose major problems. However, reforms in the administrative structure have not been undertaken nor legislation adopted, in particular concerning fleet registry, control policy and norms of commercialisation in order to ensure the implementation of the Common Fishery Policy.

The Department of Fisheries has a specialised inspectorate comprising eleven full-time inspectors with three fast control vessels at their disposal. Control mechanisms on inspection facilities and infrastructure will have to be strengthened.

3.9 Energy

More than 90% of Cyprus' primary energy supply needs are met by crude oil and oil products. Cyprus remains almost entirely dependent on imported fuels (97%). The final energy consumption increased over the last decade at an average rate of 7% per year. The State owns the majority of shares in the refinery and in the Electricity Authority in Cyprus (EAC), which is a vertically integrated enterprise.

Cyprus has not yet transposed the EU Internal Energy Market Directives and will have to introduce competition. Considering the national trend of electricity consumption, Cyprus should very soon exceed the level characterising an isolated network in EU legislation.

Cyprus will have to adopt EU legislation on crude oil and oil products trade, including fiscal matters. The harmonisation of excise taxes will in principle affect the price of diesel oil which would have to increase by 150% in order to be in line with the EU Directive on excise. This will have an impact on public and private transport since around 30% of vehicles are diesel fuelled. Cyprus will have to comply with EU oil products specifications which may impact on the competitiveness of its sole refinery.

Legislation on oil stocks needs to be aligned. Cyprus legislation provides for the adoption of specific legislative measures in case of crisis. The EU requirement is to hold 90 days of oil stocks. Presently, oil stock obligation in Cyprus is at the level of 30 days of fuel stocks in power stations and the storage capacity is no higher.

Considering other EU harmonisation areas, the regulations on the improvement of air quality may prove costly to implement. National regulatory energy objectives for emission control in power stations and use of unleaded gasoline as well as the use of low sulphur diesel are not yet in place.

The energy efficiency potential in all end-use sectors remains important since little progress in this field has been made in recent years.

Conclusion

The national regulatory energy objectives remain to be incorporated in the legal framework for energy. The vast majority of the *acquis* still needs to be transposed. Special attention needs to be paid to the alignment and subsequent enforcement of the *acquis* on the Internal Energy Market, energy efficiency and oil stocks. Cyprus has institutional structures and capacities to implement the *acquis* in the field of energy.

3.10 Environment

In the early 1990s, Cyprus adopted environmental legislation that partly transposes the acquis in air quality, water quality, dangerous substances and nature protection. Since then, no further transposition has taken place. The vast majority of the acquis thus remains to be transposed. The Cyprus authorities have begun preparation of a framework law that should represent an important step towards harmonisation of the environmental acquis.

Considerable implementation activities, partially in line with the acquis, are taking place, in particular, in the wastewater sector.

The Environment Service, within the Ministry of Agriculture, Natural Resources and Environment (MANRE) has considerable responsibilities with very limited staff. Due to the staff situation and conflicting spheres of competences between the institutions involved in environmental protection, the Environment Service needs to be significantly reinforced in order to ensure the proper implementation of the acquis.

Conclusion

Cyprus still needs to transpose most of the EC environmental legislation. The adoption of the environmental acquis can only be successful if the existing environmental management structures are substantially strengthened and if the levels of public and private investments are increased, especially in the air, waste and water sectors.

3.11 Telecommunications

Cyprus has set up a task force to prepare the implementation of the Government's decision of March 1998 on the establishment of a national regulatory authority, the gradual liberalisation of the market for telecommunications services and the adoption of a new regulatory framework including a telecommunications law. No time-limit has been indicated as to when this would be completed. Certain steps towards the adoption of the acquis have already been taken, such as the liberalisation of the terminal market (with the exception of payphones in public areas and very small aperture satellite terminals), the international access code and the single European emergency number as well as the reservation of frequency bands for GSM, ERMES and DECT. Significant alignment efforts are still necessary, in particular on market opening.

As far as postal services are concerned, the necessary legislation has not been adopted or enforced. A significant effort will also be needed at operational level to ensure that the universal postal service meets the required standards, in particular in terms of quality of service.

Despite some progress achieved, significant measures towards approximation of legislation and market opening within the telecommunications and postal sectors are needed in order to bring them into line with the acquis. Cyprus has requested a transitional period for the liberalisation of the telecommunications market and the

establishment and operation of the telecommunications national regulatory authority until 31 December 2003.

3.12 Audiovisual

Cyprus' audiovisual legislation is aligned with the 1989 audiovisual acquis following the entry into force of the audiovisual law in January 1998. Some discrepancies remain, however, with respect to the 1997 amendments to the acquis. The Cypriot authorities have undertaken to complete the transposition process with a view to implementing the acquis fully by the end of 1999. Implementation and enforcement of the legislation is to be ensured by the Cyprus Radio-Television Authority which was established by the audiovisual law of 1998.

3.13 Transport

During the last decade, Cyprus has turned into a major international shipping centre. It now has the fifth largest ship registry in the world with 2,800 ships (including yachts) and it is one of the largest third-party ship management centres with more than 100 ship management and ship owning companies. Meanwhile, Cyprus has only achieved limited progress in the transposition of the acquis. This is of particular concern because of the importance of its shipping fleet.

Similar concerns arise on the enforcement of safety standards. Although there has been progress in, for example, setting up a global network of Flag State Control Inspectors, Cyprus still does not apply certain IMO Conventions. Furthermore, the work undertaken to establish better safety standards in maritime transport has yet to show its effects through a significant reduction in the very high detention rate of Cyprus flag vessels.

In other sectors, Cyprus has made further progress in harmonising its legislation with the acquis. In particular, it has introduced new legislation to transpose parts of the road transport acquis. Progress in road transport has yet to be made, in particular on safety/weights and dimensions. Similarly, further transposition is outstanding in the field of air transport safety, in order to allow Cyprus to become a full member of Joint Airworthiness Authorities.

The screening exercise in the field of transport should allow for a precise assessment of the degree of effective implementation of the acquis. It is, however, noteworthy that Cyprus is not yet a signatory to a number of the more important multilateral conventions in road transport under the UN-ECE (AETR, ADR, ATP), all of which are incorporated into the acquis. The Commission is currently establishing a co-operative programme with Cyprus for the development of safety oversight capabilities in the Department of Civil Aviation of Cyprus.

Conclusion

Efforts on maritime safety remain very limited. The outstanding transposition raises particular concern due to the size of the fleet, the lack of enforcement of standards and the subsequently persisting high detention rates.

Progress has been achieved in the fields of air and road transport, though further efforts will be necessary. Enforcement capacities need further monitoring.

3.14 Education, Training and Youth

Cyprus' legislation incorporates the only act needing transposition, i.e. the Directive on the education of children of migrant workers.

Free circulation of persons and the principle of non-discrimination, in particular, on grounds of nationality must be applied throughout the fields of Education, Training and Youth.

Since 1 November 1997 Cyprus has been participating in the Community programmes in the field of education, training and youth. 22 schools with over 1000 students and 21 teaching staff have participated in the Socrates programme so far. 20 organisations have participated in the Leonardo programme and about 300 young people in 30 projects in the Youth for Europe programme.

Participation in the programmes should represent an effective preparation for accession and enhance the effective implementation of the acquis. Further to these programmes, Cyprus should prepare the implementation of EU youth policies and, in particular, the participation in the European Voluntary Service.

3.15 Science and Research

In 1994, Cyprus redirected its overall RTD policy with the aim of enhancing transfer of technology, adapting existing technology and fostering efforts towards technological generation in certain areas of specialisation. Expenditure on RTD has increased substantially in recent years as a result of this new policy, the establishment of the University of Cyprus and the expansion of research activities by the Cyprus Institute of Neurology and Genetics.

The acquis in this field does not require transposition into national legislation. The main acquis is the Framework Programme in which Cyprus has requested participation.

3.16 Consumer Policy

Legislation in the field of Consumer protection is mostly aligned to the acquis. However, Cyprus does not yet appear to have laws covering Comparative Advertising, Distance Selling, Timeshare and Consumer Credit. Furthermore, the existing legislation on Price Indication and Misleading Advertising does not fully implement the relevant Community directives. Amendments to the legislation on general Product Safety and on Dangerous Imitations are still needed to align the legislation with the acquis.

The Consumer Protection Board will need to be reinforced to ensure implementation of the acquis and staff will need to be trained accordingly. Consumer Protection

Associations are not sufficiently strong and will need to receive more official and financial support.

Conclusion

Despite good progress achieved, efforts are still needed in order to ensure full harmonisation of legislation and its enforcement.

3.17 Statistics

The Department of Statistics and Research of Cyprus is committed to the adoption and implementation of the statistical acquis including its legally non-binding parts. However, Cyprus still has some way to go to meet the EU system. Substantial progress has been made in the fields of agriculture, forestry and fishery statistics. Numerous classifications used in the EU are already applied, though they are yet to be extended to all sectors concerned.

In the process towards full alignment, the following issues deserve special attention: several new data collection systems are needed for demographic, social and regional statistics. Labour cost and public health surveys should be introduced as well as statistics on home and leisure accidents. In the area of business statistics, a number of existing surveys need to be adapted and extended. To improve the macro-economic statistics, the provision of basic statistics should be strengthened. Quarterly national accounts, environmental accounts, account by institutional sector and financial accounts are still needed. Existing production accounts have to be complemented by economic accounts at regional level.

3.18 Financial Control

The implementation of Community policies, especially for agriculture and the structural funds, requires efficient management and public internal control systems for public expenditure, with provisions to fight fraud. Approximation of legislation is moreover needed to allow the system of own resources to be introduced, with satisfactory provisions for accounting.

According to the information obtained from the Cypriot authorities so far, proper public internal financial control systems seem to have been established. The legislation and the accounting system incorporate control systems that ensure adequate levels of protection for Government public funds and the financial interests of the Community. While the structures of Financial Control seem to correspond to EU structures, the accounting internal control and auditing procedures need to be strengthened.

3.19 Cooperation in the fields of Justice and Home Affairs

The Government of Cyprus has undertaken to fulfil all the obligations and responsibilities arising from the EU Treaty. This implies acceptance by the Cypriot authorities of all decisions on cooperation in justice and home affairs as stipulated in Title VI of the Treaty.

It will require a major effort on the part of the authorities to ensure that all means are put in place in order to reach full cooperation in these fields.

Immigration / Border controls

Given its geographical situation and proximity to certain countries of origin (and transit) of illegal immigrants, the situation in Cyprus needs to be closely monitored. Illegal entry has been known, but has so far not reached levels of particular concern.

In 1998, the law on foreigners and immigration was amended and tougher penalties introduced for those found guilty of assisting clandestine immigration, such as ship owners and ship's captains.

Police

In November 1996 Cyprus ratified the Council of Europe Convention of 8 November 1990 on laundering, search, seizure and confiscation of the proceeds from crime. Prior to that, a number of measures had been included in the law of April 1996 on preventing and curbing money laundering activities, which provided for practical measures. A special unit to combat money laundering, composed of representatives of the ministries responsible for justice, the police and customs, was set up. A number of other measures applicable to money laundering (instructions to the banking sector, monthly report on unusual transactions of over USD 10 000, "offshore" companies, etc.) were taken incorporating certain internal market rules.

Narcotics

Cyprus is not a drug-producing country. However, its geographical situation makes it a transit point for trafficking from Turkey and Lebanon. Penalties for drug trafficking range from four years to life imprisonment.

Cyprus has ratified the United Nations Convention against the Illicit Traffic in Narcotic Drugs and Psychotropic Substances of 20 December 1988. However, it has not yet ratified the Agreement on Illicit Traffic by Sea, implementing Article 17 of the UN Convention. To coordinate drugs policy, the Cypriot authorities have set up a national committee to prevent the trafficking in and use of illicit drugs. Drugs liaison officers from 12 countries are stationed in Cyprus and cooperate with the Cypriot police and customs authorities.

Judicial cooperation

In the field of Civil procedures, Cyprus has not yet signed the Hague Conventions on Civil Procedure (1 March 1954) or Access to Justice (25 October 1980).

In the field of criminal procedures, it has not yet ratified the European Convention on Mutual Assistance in Criminal Matters (Strasbourg, 20 April 1959) and the Additional Protocol thereto of 17 March 1978. Nor has it signed the European Convention on the Transfer of Proceedings in Criminal Matters (Strasbourg, 15 May 1972) or the Additional Protocol to the Convention on the Transfer of Sentenced Persons (Strasbourg, 18 December 1997).

Conclusion

Cyprus has made progress in a number of areas, especially in combating money laundering, drugs trafficking and, more recently, illegal immigration. It must press ahead with its efforts.

In other areas, Cyprus will have to adopt the international laws relating to civil and criminal procedures without delay and ensure that rules on asylum and immigration are applied to EU standards.

3.20 General Evaluation

As regards the adoption of the *acquis*, a large number of the instruments required for the progressive adaptation of the *acquis* are already contained in the 1973 Association Agreement and the 1987 Protocol. On the basis of these instruments, Cyprus has made significant progress in adopting the *acquis* most notably in the context of the Customs Union. However, substantial efforts have yet to be undertaken in the internal market field and, in particular, in the off-shore and financial sectors.

Furthermore, maritime transport, telecommunications as well as justice and home affairs constitute other areas of particular concern. Cyprus should not face major problems in adopting the *acquis* with regard to the 16 chapters already screened.

As concerns Cyprus' administrative and judicial capacity to apply the *acquis*, it seems that major problems will not be encountered. However, administrative capacities remain to be strengthened in a number of areas, including the internal market, maritime transport, telecommunications, environment, and justice and home affairs.

4. CONCLUSION

In the political field, continuing attention needs to be paid to avoid measures which could create additional tensions on the island and could make the creation of a bi-zonal and bi-communal federation more difficult.

Despite the efforts to achieve a political solution to the continuing division of the island, it has not been possible to reach a comprehensive settlement in accordance with UN Security Council Resolutions. The invitation of the Cyprus government to include representatives of the Turkish Cypriot community in the negotiations has not so far been taken up. This has meant that the analytical examination of the *acquis* could not cover Cyprus as a whole

In the economic field, developments since 1993 confirm that the Cyprus economy possesses the ability to adapt to the challenges posed by the adoption of the *acquis* and that the authorities appear committed to restoring a stable macroeconomic environment and a favourable business climate. As a result of the characteristics of the country, notably its insularity and the continuous wage pressures and wage rigidity (also related to the full employment situation), Cyprus has in recent years lost competitiveness in traditional sectors (industry and tourism). This is also reflected in the declining trend of domestic exports to the EU. But the importance of the tertiary sector has continued to increase, while efforts have been made to reduce the overdependence of the economy on tourism. This trend can be expected to continue. The most notable development has been the large and growing importance of the international business sector, in particular the offshore banking sector. It will be important to ensure that the sector's activities are in line with the *acquis*. Another equally important challenge will be to restructure the domestic financial sector with a view to ensuring that it can withstand competition stemming from capital account liberalisation.

The integration of the northern part of Cyprus, especially if taking place in the context of Cyprus accession to the EU, will not raise major economic difficulties, because of its relatively small size and its potential, in particular in terms of agriculture and tourism. However, it will be important to bring the basic infrastructure up to the standards of the southern part of the island.

As regards the adoption of the *acquis*, a large number of the instruments required for the progressive adaptation of the *acquis* are already contained in the 1973 Association Agreement and the 1987 Protocol. On the basis of these instruments, Cyprus has made significant progress in adopting the *acquis* most notably in the context of the Customs Union. However, substantial efforts have yet to be undertaken in the internal market field and, in particular in the off-shore and financial sectors. Furthermore, maritime transport, telecommunications and justice and home affairs constitute other areas of particular concern. Cyprus should not face major problems in adopting the *acquis* with regard to the 16 chapters already screened.

It seems that major problems will not be encountered as concerns Cyprus' administrative and judicial capacity to apply the *acquis*. However, administrative capacities need to be strengthened in a number of areas, including the internal market, maritime transport, telecommunications, environment, and justice and home affairs.

ANNEXES

STATISTICAL DATA

STATISTICAL DATA

	1993	1994	1995	1996	1997
Basic data	in 1000				
Population (end of the year)	722,8	729,8	735,9	741,0	746,1
- Government controlled area	629,8	638,3	645,3	651,8	657,9
- estimates for the native Turkish Cypriots	93,0	91,5	90,6	89,2	88,2
Total Area	925,1	925,1	925,1	925,1	925,1
National Accounts	in millions of Cypriot Pound				
Gross Domestic Product at current prices	3.275	3.651	3.980	4.135	4.343
	in millions of ECU				
Gross Domestic Product at current prices	5.627	6.269	6.802	7.078	7.477
	in ECU per capita				
Gross Domestic Product at current prices	9.016	9.890	10.600	10.922	11.424
Structure of Production	in % of Total Gross Value Added				
- Agriculture	6,0	5,2	5,4	4,9	4,5
- Industry	16,0	15,6	15,1	14,8	14,3
- Construction	10,1	9,4	9,0	9,0	8,4
- Services	67,9	69,8	70,5	71,3	72,8
	as % of Gross Domestic Product				
Structure of expenditure	in % of Gross Domestic Product				
- Final consumption expenditure	76,0	74,3	76,2	78,9	79,2
- household and NPISH	59,1	57,6	59,7	60,9	60,6
- general government	16,9	16,7	16,5	18,0	18,6
- Gross fixed capital formation	22,6	20,6	19,3	20,4	18,4
- Exports of goods and services	47,3	47,5	46,5	46,9	46,4
- Imports of goods and services	47,7	48,1	50,3	53,4	52,3
	% change over the previous year				
Gross Domestic Product	0,7	5,9	5,8	2,2	2,5
	in Purchasing Power parities				
Gross Domestic Product per capita	n.a.	n.a.	n.a.	n.a.	n.a.
Inflation rate	% change over the previous year				
Consumer Price Index	4,9	4,7	2,6	3,0	3,6
Balance of payments	in millions of Cypriot Pound				
-Exports of goods	387	433	510	597	606
-Imports of goods	-1.181	-1.331	-1.499	-1.667	-1.705
-Trade balance	-794	-898	-989	-1.070	-1.099
-Services, net (incl. transfers)	865	957	911	863	921
-Income, net	-20	-23	-12	-16	-2

-Current account balance	51	36	-90	-223	-180
-Capital and fin. acc. (excl. official reserves)	-14	66	-69	186	184
-Reserve assets	-72	-121	164	28	24
Public Finance	in % of Gross Domestic Product				
General Government Deficit	2,4	1,4	1,0	3,4	5,1
Gross foreign debt (incl. long-term and short-term debt)	37,6	32,9	29,2	27,3	30,3
	1993	1994	1995	1996	1997
Financial indicators					
Monetary Aggregates	in millions of Cypriot Pound				
- M1	548	575	614	653	704
- Quasi-money	2.451	2.798	3.146	3.503	3.911
Interest rates	% per annum				
- Lending rate (up to)	9,0	8,5 ⁽¹⁾	8,5	8,5	8,0 ⁽²⁾
- Deposit rates (up to)					
Demand deposits ⁽³⁾	2,0	2,0	2,0	2,0	2,0
Savings deposits ⁽³⁾	4,0	4,0	4,0	4,0	4,0
Time deposits	7,0	7,0	7,0	7,0	6,5 ⁽²⁾
ECU exchange rates	1ECU=...National currency)				
- Average of period	0.5819	0.5823	0.5850	0.5841	0.5808
- End of period	0.5804	0.5835	0.5848	0.5839	0.5800
Foreign Trade	in millions of Cypriot Pound				
Imports	1.316	1.482	1.670	1.858	1.899
Exports	431	476	556	649	640
Balance	-885	-1.006	-1.114	-1.209	-1.259
	corresponding period of the previous year = 100				
Terms of trade	n.a.	n.a.	n.a.	n.a.	n.a.
	As % of total				
Imports with EU-15 (EU-12 for 93-94)	51,9	50,3	51,7	48,6	47,6
Exports with EU-15 (EU-12 for 93-94)	37,4	36,0	34,7	28,4	27,1
Demography	per 1000 of population				
Natural growth rate	9,2	8,6	7,7	7,2	6,3
Net migration rate	7,9	4,7	3,1	2,8	3,1
	per 1000 live-births				
Infant mortality rate	8,6	8,6	8,5	8,3	8,0
	at birth				
Life expectancy : Males	74,6 ⁽⁴⁾		75,3 ⁽⁵⁾		75,0 ⁽⁶⁾
Females	79,1 ⁽⁴⁾		79,8 ⁽⁵⁾		80,0 ⁽⁶⁾
Labour market	in % of labour force				
Economic Activity rate (ILO methodology)	92,5	92,7	93,0	93,4	93,2

Unemployment rate (ILO methodology) :	Total	2,7	2,7	2,6	3,1	3,4
	< 25 years	2,6	2,6	2,3	2,7	2,9
	> 25 years	2,7	2,7	2,7	3,1	3,5
Average employment by NACE branches (LFS)		In % of total				
- Agriculture and Forestry		11,9	11,0	10,8	10,5	10,0
- Industry		17,7	17,1	16,3	15,5	15,0
- Construction		9,4	9,1	9,1	8,9	8,7
- Services		61,0	62,8	63,8	65,1	66,3
Infrastructure		in km				
Length of motorways		150	158	165	173	195
Industry and Agriculture		Previous year = 100				
Industrial production volume indices ⁽⁷⁾		90,5	103,1	100,5	94,9	99,3
Gross agricultural production volume indices		103,0	91,7	116,0	99,0	86,3

Note: Data refer to the Government controlled area only, with the exception of data on total population and area which refer to the whole of Cyprus.

1. Effective as from September 1, 1994.
2. Effective as from March 18, 1997.
3. Interest rates on minimum monthly balances.
4. 1992/93
5. 1994/95
6. 1996/97
7. Data refer to Manufacturing (NACE Section D). The corresponding figures for the broad industrial sector (NACE Sections C, D and E) are: 93,5 - 103,7 - 101,5 - 96,9 - 99,8.