



Policies for Business in the Mediterranean Countries

Republic of Cyprus



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The Cyprus commitment to cooperation in the economic and financial sectors between the EU and the Mediterranean countries

Introduction

Cyprus is in a position to serve as a bridge of communication, mutual understanding and economic relationships between the EU member-states and the Mediterranean Partners, as well as a catalyst for greater convergence of policies, in order to deal with common problems and issues of concern. Cyprus is uniquely placed to play this role, being a Mediterranean country (and now also an EU member) at the crossroads of three continents. Throughout its long history it has fostered close cultural and commercial bonds with the people of Europe and the Mediterranean region. Traces of the confluence of most of the major civilisations in both the European and the Mediterranean sphere, a fact that has been a constant in Cypriot history, grace the landscape in Cyprus. This enriching historical experience allows the Republic of Cyprus today to maintain excellent relations, both economic and political, with all the European Union countries, as well as very friendly and close relations with the countries in the Middle East. As a new member of the European Union, Cyprus has to strive to further enhance the Mediterranean dimension of the European Union's policy priorities, by exploiting its privileged position. Furthermore, the European Union is able to benefit from Cyprus' close and excellent relations with the countries of the region, in further strengthening and enriching its relations and enhancing cooperation with the Mediterranean partners.

After this, the Government of Cyprus attaches great importance to Research and Technological Development (RTD), as it recognises its contribution towards the attainment of the development objectives in the fields of productivity and competitiveness, towards the acquisition of new knowledge and the adoption of advanced technology, across the whole spectrum of the productive process.

For this reason, during the last few years RTD activities in Cyprus have been significantly expanding, mainly as a result of the establishment of the University of Cyprus and the increase of research activities undertaken by a number of research organisations, in the public as well as in the private sector. The establishment of the Research Promotion Foundation - an institute responsible for the co-ordination and support of research activities - has also been an important step towards the promotion of RTD in Cyprus. Moreover, the participation of Cyprus in the Fifth Framework Programme for Research, Technological Development and Demonstration Activities of the European Union, is considered of utmost importance, as it plays a catalytic role in the

expansion of research activities and enables Cypriot scientists to create networks of co-operation and interact with their European colleagues. Moreover, within the framework of the New Industrial Policy, in order to aid the Development of High Technology Industry in Cyprus, the Government is promoting the concept of Incubators for high technology companies and centres for carrying applied research and development in high technology fields.

1. Cyprus economic outline

In terms of per capita income, currently estimated at US \$13.000 (2000), Cyprus is classified among the high-income countries. These achievements appear all the more striking, bearing in mind the severe economic and social dislocation created by the Turkish invasion of 1974 and the continuing occupation of the northern part of the island by Turkey¹.

This success of Cyprus in the economic sphere is attributed, inter alia, to the adoption of a market oriented economic system, the pursuance of sound macroeconomic policies by the Government as well as the existence of a dynamic and flexible entrepreneurship and a highly educated labour force. Moreover, the economy benefited from the close cooperation between the public sector and the social partners.

So, nowadays Cyprus has an open, free-market, serviced-based economy with some light manufacturing. Besides, internationally, Cyprus promotes its geographical location as a "bridge" between West and East, along with its educated English-speaking population, moderate local costs, good airline connections, and telecommunications.

In the past 20 years, the economy has shifted from agriculture to light manufacturing and services. The service sector, including tourism, contributes 75.7% to the Gross Domestic Product (GDP) and employs 70.7% of the labour force. Industry and construction contribute 19.7% and employ 21.3% of labour. Manufactured goods account for approximately 63.6% of domestic exports. Agriculture and mining is responsible for 4.6% of the GDP and 8.0% of the labour force (potatoes and citrus are the principal export crops).

The average rate of growth in the 1990s was 4.4%, compared with 6.1% in the 1980s. In the last two years (2002 and 2003), annual economic growth dropped to 2.0%, compared with 4.0% in 2001 and 5.1% in 2000. In 2003, unemployment increased to 3.5% of GDP, from 3.2% the year before. Inflation also recorded an increase to 4.1% from 2.8% in 2002. As in recent years, the services sectors, and tourism in particular, provided the main impetus for growth, while economic activity in manufacturing and agriculture remained about the same in 2003.

¹ http://www.cyprusisland.com/01_Information/economy.htm

Trade is vital to the Cypriot economy: the island is not self-sufficient in food, and has few natural resources. The trade deficit decreased by 9.2% in 2003 (on account of a considerable reduction in imports), reaching \$3.0 billion.

Cyprus must import fuels, most raw materials, heavy machinery, and transportation equipment. More than 50% of its trade is with the European Union, particularly with the United Kingdom. Growth in 2004 is expected to accelerate to 3.5%, due to a revival in tourism. Unemployment is expected to remain around 3.6% in 2004, while inflation is forecast to drop considerably to 2.5%. The fiscal deficit is forecast to decline to 4.4% of GDP in 2004, compared with 5.4% in 2003, remaining above Maastricht targets.

During the past decade, the Cyprus economy has intensified its links to Europe.

The Republic of Cyprus considers the financial support by the European Union to be vital for the transition economies in the Mediterranean and the reduction of the economic gap between the other EU states and the Mediterranean countries. To this end, the Republic of Cyprus is willing to work towards regional cooperation in a variety of fields such as maritime transport, the environmental protection of the sea from maritime accidents, development of infrastructure facilities, structural economic reforms and measures to relieve the lower-income sectors of hardship caused by economies in transition, policies to attract more foreign direct investment in the region

The relations with the European Union, the largest trading partner of Cyprus, are currently governed by a Customs Union Agreement, which basically provides for a gradual and mutual dismantling of trade barriers. In July 1990, the government of the Republic of Cyprus submitted an application to become a full member of the European Union. The European Commission, in its opinion on the application of Cyprus, recognised the ability of the Cyprus economy to adapt rapidly to the EU *acquis*. In March 1995, the Council of Ministers of the European Union declared that accession negotiations between the European Union and the Republic of Cyprus will begin six months after the completion of the Intergovernmental Conference, which opened its sessions in March 1996.

Substantive accession negotiations between Cyprus and the EU started on the 10th November 1998.

Cyprus has now been a member of the EU, since 1 May 2004. Like this, the economic manoeuvres of the Government in favour of the national enterprises has to follow the community bodies' indications².

² <http://www.mfa.gov.cy/mfa/mfa.nsf/EUCyprusandEuomedPartn>

2. Industry in Cyprus

Looking at the industry situation in Cyprus, even though the blow inflicted on the manufacturing sector by the Turkish invasion of 1974 was severe, recovery during the 1975-83 period was remarkable. In the post invasion period in particular during 1975 -1983 the sector has been growing at an average annual rate of 9,1% and has become increasingly important for the economy, especially when emphasis was geared to supplying the foreign markets³.

By 2002 the sector accounted for about 10% of GDP and 12% of employment. Exports of manufactured products in 2003, compared to 1973 figures (£15 million), recorded a large increase and reached about £191,6 million. The most important sectors in terms of value added are food and beverages (we noted that Cyprus exports potatoes and citrus fruits), clothing, furniture and metal products. Other industrial sectors, which continue to expand, include printing and publishing, plastics, chemical and pharmaceutical products.

The manufacturing industry of Cyprus has been going through difficult times in the past decade, experiencing a fall in the growth of production, exports and employment. This development has been the result of an erosion in Cyprus competitiveness, both abroad and in the local market, at a time of increasingly intensified, international competition. At the root of these problems lie the structural weaknesses of the sector, the drastic reduction of tariff protection due to the participation of Cyprus in the World Trade Organization, rising labour costs and low productivity. As a result the share of the manufacturing sector in the Gross Domestic Product and in employment remained stagnant.

International competition is increasingly intense mainly from two directions: on the one hand, the high-wage producers, who have combined design, quality and new forms of flexible production to cut working and capital costs and improve response times; on the other hand, the low-wage mass producers of South-East Asia.

Faced with this situation, having thoroughly considered ways and means for the reconstruction and development of the sector, the Government has reformulated its policy to facilitate the process of modernization and technological upgrading of the productive fabric of the economy within the framework of harmonization with EU Regulations and the Community *Acquis* in general.

More specifically, the Government has set amongst its priorities the following basic goals:

- Attraction and development of new high-tech industries
- Assistance and reconstruction of Cyprus traditional industry
- Productivity improvement

³<http://www.cyprus.gov.cy/cyphome/govhome.nsf/LookupIDs/38933BBC83EC7298C2256B6B002FC8AD?OpenDocument&languageNo=1>

- Attraction of capital intensive foreign investment

Foreign capital would also play a major role in these efforts, as it contributes substantially to the introduction of high technology, know-how and expertise. Furthermore, the full liberalization of the capital markets, within the context of harmonization with the European Union, will add impetus to the inflow of foreign investment capital and the creation of joint ventures.

The recent accession of Cyprus to the European Union will provide small and medium sized Cypriot enterprises with the opportunity of participating in the various community programmes concerning industrial technology, professional training, product development, marketing etc., thus further enhancing the restructuring process. Cypriot firms will also be presented with the challenge of penetrating the European market of 450 million consumers.

3. The new industrial policy of the Cyprus Government

To obtain the quoted results, one of the primary objectives of the Cyprus Government development policy concerns the restructuring and, in the recent past, the modernization of the productive fabric of the economy in order to assist enterprises to meet the challenges of globalisation and of the competition between the European Union. To this end, various support schemes have been introduced in the different sectors of economic activity. Although the schemes do not generally distinguish between micro, small, medium or large units, in view of the predominance of SMEs in all sectors, size is one of the parameters which is seriously taken into account in policy formulation.

The Government of Cyprus emphasized the need for a regulatory climate conducive to investment, innovation and entrepreneurship. It stressed the need to lower the costs of doing business and to remove unnecessary procedures which act as barrier against the growth and development of SMEs in Cyprus. It is well understood that enterprise policy in Cyprus must ensure competitiveness in all areas of economic activity.

The development of the island's economy has been increased, as we said before, by the manufacturing industry of Cyprus. The sector accounts for about 10% of GDP and 12% of employment. In recent years the sector has been going through difficult times and it is currently experiencing a fall in the growth of production, exports and employment. This has been the result of the erosion of its competitiveness, both abroad and in the local market, due to rising costs of production and insufficient productivity gains, at a time of increasingly intensified international competition. At the root of these problems lies the structural weaknesses of the sector, the low level of investment in new technology and low capacity utilization.

Taking into account the forthcoming challenges stemming from the globalisation of the economies, the liberalization of trade, the rapid technological changes, as well as the accession of Cyprus to the EU, the Ministry of Commerce, Industry and Tourism has introduced a New Industrial Policy.

The main objectives of the New Industrial Policy are the following: a) Provision of support for the restructuring of the Cypriot traditional industrial sector; b) Provision of assistance to existing production units and the attraction and the development of new high-tech industries; c) Attraction of capital-intensive foreign investment; d) Creation of an environment favourable to cooperation between undertakings; e) Fostering better exploitation of the industrial potential of policies on innovation, research and technological development.

Within the framework of the above objectives the Ministry of Commerce, Industry and Tourism adopted the New Industrial Policy that covers the following twelve Chapters:

1. High technology-business Incubators
2. High technology-research and development
3. Foreign Investors Service Centre (One-Stop Shop)
4. Mergers, Acquisitions and Sub-contracting
5. Laboratories and inspections for quality improvement
6. Government guarantees for loans to small and medium-sized enterprises
7. Subsidization of studies
8. Energy conservation
9. Tax incentives to industries
10. Incentives to promote exports of manufactured products
11. Development of the Larnaca Free Zone
12. Government Grants to manufacturing industries

The Ministry of Commerce, Industry and Tourism, continued the implementation of the measures and incentives included in the New Industrial Policy. In view, however, of the enactment of the Law concerning the control of State Aid, all the schemes and incentives included in the New Industrial Policy have been submitted for assessment to the Commissioner of State Aid. The schemes and incentives that are not compatible with the new Law are in the process of being modified to be in line with provisions of the above law.

4. Telematic infrastructures for enterprises

At first, in the view of the technological development, Cyprus adopted the guiding principles of the national strategy on the Information Society in mid 2000. This strategy, on the basis of which an action plan has been drawn,

pertaining to the structure, characteristics and the needs of the Cyprus economy, takes into account the overall economic and social policy objectives, and its main pillars are the creation of a modern and technologically advanced infrastructure, the introduction of a regulatory legal framework, and the establishment of an enabling environment encouraging the effective participation of economic units and the wider public.

As for the introduction of e-Europe, the national action plan priorities and the short and medium-term measures have been reviewed in order to accommodate the specific measures that have been adopted therein. The involvement of the private sector, including employers, SMEs organizations and trade unions in redesigning policy measures was given particular attention.

In Cyprus, the body that takes responsibility for the formulation of national strategy on issues relating to the information society, for the approval of policies specific measures and the monitoring of their implementation is a Ministerial Committee, chaired by the Minister of Finance. Members of the Committee are the Ministers of Communications and Works, of Education and Culture and of Interior. The executive arm of the Ministerial Committee is the Planning Bureau, which deals with all development policies of the Government. Other ad hoc committees are formed from time to time, which examine in an exhaustive manner specific issues, technical or other.

In this way particularly, e-Commerce is increased.

As the developments in telematic applications, and in particular those relating to electronic commerce, move at a very fast pace, the Planning Bureau, which is the authority responsible for development policies in Cyprus, has taken the initiative to prepare a national strategy for the development of electronic commerce, including the introduction of the appropriate legal framework. A specialized study was launched at the beginning of 2002, which contributes to the development of a firm action plan for the effective implementation of the strategy, which will be consistent with the strategic objective of Cyprus to develop into an international electronic commerce hub⁴.

The study comprises three phases:

- 1) The First Phase provides for the assessment of the existing environment and the identification of the comparative advantages of Cyprus, as well as of the constraining factors in developing e-Commerce.
- 2) The Second Phase is the Strategy formulation and implementation, which will specifically address electronic transactions falling under all domains involving Businesses, Consumers and Public Administration.
- 3) The Third Phase will provide for the formulation of the legal framework.

⁴http://europa.eu.int/comm/enterprise/enlargement/charter/report_2003/cyprus20902.pdf

Particular importance is attached on issues relating to confidence, trust and security, as these are considered to be vital pre-conditions for the successful introduction of on-line transactions, as well as for other applications⁵.

Particularly important for our topic is the Cyprus Productivity Centre (CPC) website, offering information on all its activities: <http://www.kepa.gov.cy>.

Since 2001 the web site has been upgraded and applications to all CPC training programmes can be submitted on line.

The CPC is in the process of developing a Business Portal Service which will provide the business community as well as private individuals with information on areas such as training opportunities, productivity and quality issues, European Union matters, support schemes available, best practices etc. In addition the portal will include online tools, such as audits and training.

The Cooperative Development Department (CDD) maintains a website at <http://www.pio.gov.cy>, where there is information about the Department's operations and duties, its personnel, the legislation regarding Cooperative Societies and information on the Cooperative Movement in Cyprus. Cooperative Societies.

5. Financing for enterprise

The New Industrial Policy, as we told above, promotes both foreign investments in Cyprus and public financing for enterprise.

Starting from the latter, we see that a competitive financing environment for all companies is a key element in promoting an entrepreneurial economy and strengthening growth. Between the organisms that take care of financing for enterprises there is first of all the Cyprus Development Bank (CDB), established in 1963 to act as a catalyst for accelerating the pace of economic and social growth in Cyprus through the mobilisation and efficient allocation of scarce human and capital resources⁶.

CDB's capital and services products promote the adjustment, reorientation and acceleration of the speed of response of private businesses and public institutions to international competition and market opportunities and support business efforts and projects for expansion abroad. CDB also facilitates by its actions and policy recommendations the establishment of a hard and soft infrastructure and management environment which it expects to prove conducive to the attainment of the above referred to development objectives.

CDB pursues its objectives through two core activities: Banking and Consulting. Banking comprises Corporate Banking, Investment Banking and

⁵ The Human Resource Development Authority (HRDA) has established an Internet presence by creating its own web page (<http://www.hrdauth.org.cy/hrdav1en/>) that provides users and especially its customers whose vast majority are SMEs, with up-to-date informations

⁶ <http://www.ciim.ac.cy/default.asp?pc=312>

Project Financing. Consulting consists of Management Consulting, Project Management.

Under its banking activities CDB provides bespoke loans, equity funds and venture capital for financing enterprises and projects, as well as the establishment of new businesses. It engages in a broad range of investment banking activities including mergers and acquisitions, the flotation of companies and other capital markets transactions.

CDB also promotes the creation of, and participates in investment and venture capital funds in co-operation with local and foreign investors.

For further developing businesses and strengthening national competitiveness, CDB attaches great importance to its activities as consultants to private and public entities and organisations. Through these CDB is making a significant contribution to the development of the competitiveness of the Cyprus economy, and the Cyprus Government is a principal client of CDB on matters of strategic setting and management of the basic factors of the domestic economy.

For the purpose of promoting and achieving its goals CDB itself is increasingly playing a regional role mainly in the Balkans and in a number of CIS and Eastern Mediterranean countries, either through direct action by undertaking initiatives and projects in these countries or indirectly by its support of Cypriot businesses to expand abroad.

Another form of financing for Cyprus, now that it is a member of the EU, comes from the European Funds. The European Commission is committed to this path in order to help Europeans free up their entrepreneurial and innovative potential⁷.

A third way of financing comes from the Government.

6. The Institution of Business Incubators

We mentioned before that the first two chapters of the New Industrial Policy refer to the promotion of high technology industries in Cyprus through the establishment of Incubators and the creation of a Center for carrying out applied research and development in high technology fields⁸. Business Incubators are institutions through which the necessary support is given to new inventors in order to develop and market their innovative ideas, while at the same time they help create and organise a new enterprise which will utilise the new products being developed⁹. It has been introduced by the Ministry of Commerce, Industry and Tourism. The concept of the Incubator for high

⁷ <http://www.delcyp.cec.eu.int/en/news/031122i.htm>

⁸ <http://www.hri.org/news/misc/confs/2000/00-02-26.conf.html>

⁹ <http://www.agrino.org/hightech/newindustrialpolicyengl.htm>

technology companies is based on the realization that researchers or inventors may be very good in their field, but do not necessarily possess the necessary entrepreneurial skills and experience to make good businessmen. In addition, the initial stages of creating an enterprise in the high-tech field involve many risks, which act as a deterrent for external investors. As a result, many excellent ideas are left unexploited. Incubators aim at helping new inventors or researchers in the early stages in order to develop and market their innovative ideas and create new productive enterprises based on them. The initial stages of enterprises in the high-tech field involve many risks, which act as a deterrent for external investors. As a result, many excellent ideas are left unexploited. Incubators aim at helping new inventors in the early stages in order to materialise, develop and trade their innovative ideas and create new productive enterprises. The various managing bodies of the Incubator and their responsibilities as well as the details pertaining to the Incubator's operation will be defined upon the completion of the detailed study. In general, the responsibilities of the above bodies are: to adopt a policy concerning the sectors where incubators will be involved; to approve the various procedures; to supervise incubator development and the progress of incoming enterprises; to terminate the stay in the incubator of any enterprises which fail to fulfil their obligations. The incubator offers the following basic services: a) Help in determining whether the idea can be implemented from a technological and commercial point of view; b) Help in designing the plan for research and development; c) Secretarial and accounting support, d) Scientific and consulting support; e) Help in finding the appropriate financing. As for the criteria for admission to the programme, we have to consider that applications submitted by enterprises have to involve a research and development plan, based on an innovative technological idea, which aims to develop a final product, preferably with an export orientation. With regard to the beneficiaries, Individuals or small groups are able to participate in the incubator provided they submit to the competent committee a complete operational plan which has to satisfy the pre-defined selection criteria. The incubator authorities may also consider applications involving the participation of non-Cypriot inventors. An enterprise can stay in the incubator for a maximum of 2 years, unless the incubator approves an extension. An individual (or group) who is admitted to the incubator has the obligation to form a limited liability company (LTD) in which: -50% of the company shares will be given to the inventor/s; -25% of the shares will go to the inventor's associate/s who will deposit a sum covering 25% of the capital (the inventor will have the right to deposit this sum and acquire the shares for himself); -25% of the shares will go to the incubator. The incubator will finance the limited liability company (through special budgets of the Ministry of Commerce, Industry and Tourism). In the event that the limited liability company starts operating commercially after it leaves the incubator, the company will have to

pay back 20% of the total grant amount with no interest within a period of 10 years. The incubator will release funds according to six-monthly budgets and reports describing the progress of the limited liability company. The company admitted in the incubator, has some obligations. It should, within a period of 24 months from the date of the signing of its contract with the incubator, deliver a commercial product. At the end of the 24 months period, the company will withdraw from the incubator. The incubated enterprise will have to pay symbolic amounts for the use of incubator services. The enterprise must leave the incubator after 24 months and return the facilities in the same state as they were when it first occupied them.

7. Foreign Investments

Cyprus has also agreed to make certain sacrifices. Thus the legal and fiscal regime for off-shore companies is to be phased out between now and 2005, despite its importance to the economy. New arrangements will need to be found for Cyprus to retain its position as a hub for international business dealings. Foreign investments are most numerous in the banking and petroleum sectors. Attracting foreign investors in all sectors of the economy, with special emphasis on high technology, constitutes one of the primary objectives of the Government's development policy. Towards this end, a Foreign Investors Service Centre (One Stop - Shop), which operates under the auspices of the Ministry of Commerce, Industry and Tourism, has been set up at the Ministry headquarters in Nicosia, putting into effect the third chapter of the New Industrial Policy. So, investors can take advantage of fiscal incentives and a relatively low level of taxation. But, a distinction is made between an investment made by companies from the EU and companies that are not from the EU: investment by EU residents are permitted up to 100% of the shares in companies that are traded on the Cypriot Stock Exchange. Investments of companies investing in banks are allowed up to a maximum of 50%. An individual who invests in a bank may acquire only up to 9.9%. Investments from non - EU residents in commerce and services, are permitted up to a maximum of 49%; in industry, up to a maximum of 49%; in the services sector, up to 100%. Cypriots who repatriated to Cyprus and invested foreign currency in the Cyprus Stock Exchange or Cypriots who invested foreign currency while working abroad are allowed to convert the sale proceeds into the foreign currency. However, they are allowed to convert only the amount of money that they repatriated, which means that any capital gains derived from the sale of securities cannot be converted into foreign currency. There are certain conditions, imposed by the Central Bank of Cyprus, in respect of foreign investment. Cypriot immigrants are treated in a different way compared to

foreign investors. Cypriot immigrants and foreign investors, together cannot hold more than 15% of the share capital of any listed company in the Banking Sector.

8. Turkish Cypriot Economy

Since 1975¹⁰, Cyprus has been divided *de facto* into the Government-controlled two-thirds of the island and the Turkish Cypriot one-third. The Government of the Republic of Cyprus has continued as the internationally recognized authority; in practice, its authority extends only to the government-controlled areas¹¹. The Turkish Cypriot area refers to itself as the “Turkish Republic of Northern Cyprus” (TRNC) recognized only by Turkey¹². The Turkish Cypriot economy has roughly one-third of the per capita GDP of the south. Because it is recognized only by Turkey, it has had much difficulty arranging foreign financing and investment. It remains heavily dependent on agriculture and government service, which together employ about half of the work force. To compensate for the economy's weakness, Turkey provides grants and loans to support economic development. Ankara provided \$200 million in 2002 and pledged \$450 million for the 2003-05 period. Future events throughout the island will be highly influenced by the outcome of negotiations on the UN-sponsored agreement to unite the Greek and Turkish areas. The economic disparity between the two communities is pronounced. Although the Turkish Cypriot area operates on a free-market basis, the lack of private and governmental investment, shortages of skilled labour, plus inflation and previous devaluations of the Turkish lira - which the Turkish Cypriots widely use as their currency - continue to plague the economy. Since the April 23, 2003 relaxation of restrictions on travel across the buffer zone, there have been more than 3 million crossings in both directions. Greek Cypriot spending in the north provided a short-term boost to the Turkish Cypriot economy. This initial influx has tapered off, however, as both the number of trips per month and the average spending per trip by Greek Cypriots has declined. Travel by Turkish Cypriots to the south continues, and Turkish Cypriot business are increasingly concerned that they are losing sales to purchases in the south by Turkish Cypriots. Despite initial expectations, the relaxation of travel restrictions has not yet resulted in measurable commercial trade between the two communities, largely due to barriers to trade resulting from the continued

¹⁰ Turkish Cypriot area proclaimed self-rule on 13 February 1975.

¹¹ www.stat-usa.gov

¹² <http://www.cia.gov/cia/publications/factbook/geos/cy.html>

division of the island. Turkey is, by far, the main trading partner of the "TRNC", supplying 62.1% of imports and absorbing 41.6% of exports. In a landmark case, the European Court of Justice (ECJ) ruled on July 5, 1994 against the British practice of importing produce from northern Cyprus based on certificates of origin and phytosanitary certificates granted by "TRNC" authorities. The ECJ decision stated that only goods bearing certificates of origin from the Government of Cyprus could be recognized for trade by EU member countries. The ECJ decision resulted in a considerable decrease of Turkish Cypriot exports to the EU--from \$36.4 million (or 66.7% of total Turkish Cypriot exports) in 1993 to \$13.8 million in 2003 (or 28% of total exports). Even so, the EU continues to be the "TRNC's" second-largest trading partner, with a 25% share of total imports and 28% share of total exports. Additionally, the economic crisis in Turkey has had a negative impact on "TRNC" foreign trade in the last 2 years. Total imports increased to \$415.2 million in 2003 (from \$309.6 million in 2002), while total exports increased to \$49.3 million (from \$45.4 million in 2002). Assistance from Turkey is the mainstay of the Turkish Cypriot economy. Under the latest economic protocol (signed January 2001), Turkey undertakes to provide Turkish Cypriots loans and financial assistance totaling \$350 million for the purpose of implementing projects included in the protocol related to public finance, tourism, banking and privatization. Turkey also has agreed to provide a supplementary amount of \$140 million to entrepreneurs in the form of low-interest loans with the purpose of supporting export-oriented industrial production and tourism. Fluctuation in the Turkish lira continues to exert downward pressure on the Turkish Cypriot standard of living. Turkish Cypriot authorities have instituted a free market in foreign exchange and authorize residents to hold foreign-currency denominated bank accounts. This encourages transfers from Turkish Cypriots living abroad. In short, there is a crevice into the Cyprus economy. The Greek Cypriot economy is prosperous but highly susceptible to external shocks. Erratic growth rates over the past decade reflect the economy's vulnerability to swings in tourist arrivals, caused by political instability in the region and fluctuations in economic conditions in Western Europe. Economic policy is focused on the respect of the community directives. The Government-controlled area had a robust, service-oriented economy (including tourism) with a declining manufacturing base and a small agricultural sector. For the year 2004, inflation was estimated by the Bureau of Democracy, Human Rights, and Labour, of 25February, 2004 at 4.3 percent and economic growth at 2.0 percent. The Turkish Cypriot economy was basically service-oriented, with a smaller tourism and trade base but a larger agricultural sector than the government-controlled area. For the year, inflation was estimated at 12.6 percent and economic growth at 5.4 percent

9. International cooperation in the economy

The Republic of Cyprus commitment to the creation of the conditions for shared economic prosperity and closer cooperation in the economic and financial sectors between the EU and the Mediterranean countries can be further attested by the successful completion of the Third Euro-Mediterranean Conference of Ministers for Industry, which took place in Limassol on 22 June 2000. At this meeting the Ministers agreed to support the work programme defined within the framework of the new industrial cooperation approach structured around four main priority areas: promoting investment; innovation, technology and quality; instruments and mechanisms of the Euro-Mediterranean market; SME (Southern Mediterranean Economies) development.

In order to promote more investment in the region, the Ministers in Limassol undertook to encourage national and regional investment promotion agencies to cooperate more actively. In so far as the promotion of innovation, technology and quality, the Conference in Limassol welcomed the initiative by the European Commission to prepare a regional programme for innovation and quality. Regarding the establishment of instruments and mechanisms of the Euro-Mediterranean market, the Ministers in Limassol welcomed the European Union's initiative to implement a regional programme on the aforementioned subject and underlined the importance of this programme. Finally, the Ministers agreed to devise a regional programme to improve the environment for SME (Southern Mediterranean Economies) and make them more competitive

Besides, the Republic of Cyprus firmly believes in the benefits to be accrued from the establishment of a Euro-Mediterranean Free-Trade Area. In order to achieve the wider objective of creating an area of prosperity and for the successful fruition of the aforementioned regional programmes, adequate funds, including horizontal cooperation, and more foreign direct investment in the region are necessary.

A further agreement has been signed very recently between Cyprus and Italy, on mutual administrative assistance for the prevention, investigation and repression of customs violations, published on the Italian Official Journal, of the 29 May 2004, general series, n. 102.

Italy and Cyprus consider that violations against law are prejudicial to their economic, commercial, fiscal, social, cultural, artistic, and archaeological interests.

The Contracting Parties shall through their Customs Administrations afford each other administrative assistance under the terms set out in this Agreement, for the purpose of:

- a) ensuring the correct enforcement of the customs legislation;

- b) preventing, investigating and repressing the violation of the customs laws.

10. Latest forecasts: The United Cyprus Republic

On the 31 March 2004 The Comprehensive Settlement of the Cyprus Problem was published, determining the principles underpinning the "United Cyprus Republic", an independent state, built in the form of an indissoluble partnership, with a federal government and two equal constituent states, the Greek Cypriot State and the Turkish Cypriot State¹³.

So, the P. A. system has to take the political reform in act into account.

Industry and commerce, including insurance, consumer protection, professions and professional associations are part of the points included into the project of Constitution of the United Cyprus Republic.

Conclusions

Cyprus shows points of weakness in the economic area, but also points of strength. Starting from the former, we see that, due to relatively high labour costs, the manufacturing industry, which still represents 10 % of GDP, continues to lose jobs. Cyprus is also dependent on tourism which is highly sensitive to the international situation. Natural resources are not numerous and the island has no sources of domestic energy. So, the shortage of raw materials justifies the large quantities of imports. On the other hand, since the country's independence, its economy has proved its dynamism and flexibility. Currently, agriculture is losing ground whereas the service sector is increasing in importance. Due to its performance, Cyprus is today ranked by the World Bank as a high level income country. Among the elements of its success are high GDP growth, a dynamic employment market, political stability, well developed infrastructure (transport, communications, etc.), and an expanding tourist industry. Moreover, Cyprus has a free market economy with the role of the government limited to the provision of public utilities and the necessary infrastructure. The Government also promotes and maintains favourable investment conditions, which permit entrepreneurs to participate directly in the process of economic activity. Among its other assets, Cyprus adopted an advantageous fiscal regime: taxation of company profits is only 10 %. Finally, after a necessary transitional period, EU membership will undoubtedly be beneficial for Cyprus, as it is integrated into a market with no internal boundaries, taking also into account that the European Union is the main trading partner. Despite these successes, the Cypriot State intends to stabilise

¹³ *The Comprehensive Settlement of the Cyprus Problem*, of the 31 March 2004, in <http://www.state.gov/r/pa/rmo/hglt/31329.htm>.

its high growth level, continue to improve the living standards of its inhabitants, maintain full employment conditions, reinforce the conditions of macro-economic stability and reduce the fiscal deficit.