

Joint Project of the European Social Partner
Organisations

Study on restructuring in new Member States

CYPRUS – COUNTRY DOSSIER



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The present report represents an expert view and does not necessarily reflect the view of the European Social Partners

I. INTRODUCTION: THE DOSSIER – WHAT FOR?

The following dossier introduces the main challenges faced by the Cypriot economy from the point of view of restructuring, both at company and at macroeconomic levels.

It was discussed by the Cypriot Social Partners in the presence of the European Social Partners at a common Seminar which took place on the 7 and 8 September 2005 in Nicosia.

The dossier does not aspire to build innovative insight about Cyprus' economic or social situation, neither on political nor on academic ground. It seeks to present the existing facts and data from the point of view of restructuring treated as a phenomenon, a process and an object of the public debate.




It presents different points of view. It seeks to stimulate the debate about the future of the Cypriot economy, raise issues which can be treated in a constructive way, and contribute to build trust and confidence among the stakeholders in view of mobilising them for the future of Cyprus and the Cypriot social dialogue within the European Union.

In the first part, the dossier highlights the main economic drivers and trends, and the main concerns expressed by the stakeholders in terms of growth, employment and competitiveness. Then it focuses on restructuring as a process and object of the public debate nourished by concrete cases of the restructuring on the island. It ends up presenting an overview of the social dialogue challenges and questions currently being discussed or that could possibly influence considerations on restructuring.

It is based upon interviews and the analysis of data and documentation. The list of persons interviewed, as well as sources is presented at Annex.

II. ECONOMIC TRENDS AND CHALLENGES

This section:

-  **presents drivers of growth which contribute to pushing forward the Cypriot economy,**
-  **enumerates economic challenges and macroeconomic issues which will have to be tackled with in order to preserve Cyprus' competitiveness, and**
-  **pinpoints employment and labour market challenges.**

2.1. DRIVERS OF GROWTH

Cyprus enjoys the status of a steady economy, which is characterized by robustness and macroeconomic stability. The executive Board of the International Monetary Fund (IMF), in its report of 31 January 2003 describing the situation of Cyprus' economy, stated that *"over the last two decades economic performance has been impressive, with GDP per capita rapidly approaching the average level in EU countries"*¹.

a) Steady and peaceful growth of economy...

The real growth rate of the Cyprus economy during the period 1999 – 2003 amounted to 3,5% which compared satisfactorily with the EU average². It is noteworthy that this growth was accomplished in an environment of full employment conditions, low inflation and a stable and strong currency. Cyprus is classified among the high-income countries: 16th place worldwide according to the World Bank's World Development Indicators in 2003. With GDP per capita in 2004 of € 18,200, which is equivalent to 82% of the EU average, it has a standard of living that is even higher than some "old" EU member-states³.

In 2005, economic growth is expected to reach 4%, spurred by a revival in the retail, manufacturing and tourism sectors⁴. This is in line with the stable increase in previous years that saw GDP growth rates in real terms reach 3,7% in 2004, 1,9% in 2003 and 2,1% in 2002⁵.

¹ International Monetary Fund, *IMF Concludes 2002 Article IV Consultation with Cyprus*, Public Information Notice (PIN) No. 03/13, February 14, 2003, <http://www.imf.org/external/np/sec/pn/2003/pn0313.htm>

² Eurochambers, *National Report: Cyprus*, http://www.eurochambres.be/PDF/pdf_ees2005/Cyprus.pdf

³ <http://www.cyprus.gov.cy/cyphome/govhome.nsf/Main?OpenFrameSet>

⁴ <http://www.eubusiness.com/afp/050121170943.e7v467jh>

⁵ Statistical Service of the Republic of Cyprus, *Latest figures: revised estimate of GDP for 2004*, 18 March 2005, <http://www.mof.gov.cy/mof/cystat/statistics.nsf/All/7FAF3C6E2D6CF6F1C2256FC50045EE07?OpenDocument>

The improvement is above all attributed to the acceleration of the rate of growth of domestic demand, especially with regard to private consumption and investment in construction, machinery and equipment, as well as the continuing strong performance of exports of services, even when discounting tourism⁶.

Although being vulnerable to imported inflation, the Cypriot economy is generally characterised by low and quite stable inflation – in 2004 inflation dropped to 2,3% from 4,1% in 2003.

Cyprus was ranked 25th in the United Nations 2003 Index of Human Development which takes into consideration socio-economic indicators such as the outstanding housing situation, the pollution free environment, and a low crime rate.

b) Supported by a strong and robust services sector...

Cyprus has been gradually transformed from an economy dependent on the primary sectors at the beginning of the 1960s to a fully-fledged export oriented service economy. The tertiary sector can be considered as the backbone of the economy contributing 76,4% of GDP in 2004 and over 70% of total gainful employment.

According to official data in 2002, the sectoral share of GDP was as following:

Sector	% Contribution to GDP (2002)
Agriculture	4,6%
Manufacturing and Construction	19,7%
Services	75,7%

Sources:

<http://www.cyprus.gov.cy/cyphome/GovHome.nsf/OtherUniversalidsLookup/EE71779799E76A97C2256A730037242B?OpenDocument&languageNo=1>

The main services sectors are hotels and restaurants, wholesale and retail trade, financial services, transport and communications, real estate, renting and business activities, and education. Services are followed by the manufacturing industry (the main industries are food processing, beverages, tobacco, clothing and metal products), and electricity, construction and agriculture (the principal crops are potatoes, other vegetables, citrus, cereals, grapes and olives). The main obstacle for the future development of the service sector may become poor infrastructure which influences its pace of development.

⁶ *Convergence Programme of the Republic of Cyprus 2004-2008*, Ministry of Finance of the Republic of Cyprus, December 2004, [http://www.mof.gov.cy/mof/MOF.nsf/4208432071A9E967C2256F660045AC5A/\\$FILE/CP2004_2008_Final_appendix.doc](http://www.mof.gov.cy/mof/MOF.nsf/4208432071A9E967C2256F660045AC5A/$FILE/CP2004_2008_Final_appendix.doc)

c) With a booming tourism sector as the leader...

Tourism has been the leading growth sector in the Cyprus' economy since 1980. Tourism produces "multiplier effects" throughout the whole economy thanks to its strong inter-industry relations.

According to a recent forecast by the World Travel and Tourism Council "(...) the travel and tourism sector in Cyprus is expected to grow by 3.5% in 2005 and by 5% per year for 2006-15. The WTTC expects Cyprus' travel and tourism industry to generate 10.4% of GDP in 2005 and 54,069 jobs, while the broader sector is expected to total 22.7% of GDP and 107,546 jobs (...)".⁷ At the moment, the island hosts more than two million tourists every year, of which 90% originate from European countries. Foreign exchange income amounts to approximately 20% to the island's GDP.

The Cyprus tourism sector has already attained a mature stage. At present the most fundamental issue is to re-launch the promotion campaign in order to establish Cyprus as a quality tourist destination. For that reason the strategy focuses on quality rather than on quantity, through the upgrading and differentiation of the tourist product. The basic objective of the strategy, by the year 2010, is to double the amount of income generated by tourism. This objective is to be reached through an increase in: the per capita spending of tourists, the average length of stay, and the number of arrivals; as well as through overcoming the seasonality of the sector⁸.

d) ...Becoming a worldwide shipping power

Cyprus has developed enormous expertise in shipping and the international marine freight business. Today, the island boasts one of the world's largest fleets of merchant vessels together with all the supporting infrastructure that makes the Cyprus shipping industry one of the most efficient and cost-effective in the world - it ranks 6th in the list of leading maritime nations. The Cypriot law dealing with the registration of ships (1963) together with the double tax treaties signed, the numerous bilateral agreements and the tax benefits for both foreign and local ship-owners, all contributed in generating the tremendous expansion of the Cyprus Shipping Registry, both in terms of the number of vessels registered as well as gross tonnage.

The total tonnage of ships registered under the Cyprus flag increased from 1,200 ships of 2,7 million GRT in 1978 to over 2,650 ships of over 27,8 million GRT at the end of March 2001.

Cyprus has also developed to be one of the largest third-party ship management centres with about 100 ship management companies.

⁷ <http://www.xak.com/main/newsshow.asp?id=44027>

⁸ *The Tourism Sector of Cyprus: a Brief Overview*, Symposium on Tourism Services, 20 February 2001, www.wto.org/english/tratop_e/serv_e/job01_22_cyprus.doc

e) ...Developing into a transit trade centre

Cyprus has become one of the main transit trade centres in the Eastern Mediterranean region. This development can be ascribed, inter alia, to the strategic location of the island at the crossroads of three continents, as well as to the efficient customs formalities and reliable handling and delivery system.

f) ...Respected for the quality of its financial services

Cyprus has developed into a global financial and business centre with over 30 foreign banks, two administered banking units and over 1000 fledged overseas companies operating on the island. The development of the offshore financial services sector has contributed significantly to the local economy, accounting for 5% of the GDP in 2001.

g) ...Recovering its construction sector

In the last few years the building and construction sector became a very important contributor to the island's economy.⁹ In 2001 construction accounted for almost 6,8% of the gross value added and employed nearly 9% of the workforce. Revival mainly reflects growing private sector interest in residential and commercial buildings, including growing foreign interest, and a general increase in public sector investment, especially government infrastructure projects.

h) ...Offering great conditions for investors and business creators

The attraction of Foreign Direct Investment (FDI), including the promotion of joint ventures between Cyprus and foreign enterprises, has always been a major objective of government policy, with a view to facilitate the transfer of advanced technology and expertise and promotion of the island as an international business centre of high quality. To this end, a Foreign Investors Service Centre (a One Stop – Shop facility), which operates under the auspices of the Ministry of Commerce, Industry and Tourism, has been set up at the Ministry headquarters in Nicosia.¹⁰ Furthermore, the continued liberalisation and simplification of the procedures governing the approval of FDI has been successful.

For the FDI inflow in Cyprus and FDI division by sector and the country, see Annex 1.

Reasons for investing in Cyprus are the following:

- Democratic country with stable free market economy
- Member of the European Union
- Strategic location at the crossroads of three continents
- Excellent telecommunications, airports and ports

⁹ *European Enlargement Country Profile – Cyprus*, Invest Northern Ireland, <http://www.investni.com/cyprus.pdf>

¹⁰ Giovanna Astarita, *Policies for Business in the Mediterranean Countries: Republic of Cyprus*, Centre for Administrative Innovation in the Euro-Mediterranean Region, <http://unpan1.un.org/intradoc/groups/public/documents/caimed/unpan018640.pdf>

- Modern and efficient legal, accounting and banking services based on British practices
- 100% foreign participation in all segments of the economy not only for EU citizens but also for investors from third countries
- Low corporate taxation of profits, between 20-25%
- Low taxation (4,25%) on profits of international business enterprises and international business branches managed and audited in Cyprus
- Low income tax rates, ranging from 0-20%, for expatriate employees of international business enterprises living and working in Cyprus
- Ten-year tax remission for profits resulting from the operation of projects that enrich tourism, such as golf courses, marinas, theme parks, health centres, etc.
- No customs and excise duties for operations in the Industrial Free Zone
- Bilateral treaties for the avoidance of double taxation with a large number of countries
- Bilateral investment agreements with 16 countries
- Duty-free import of machinery and transport equipment
- Duty-free import of household equipment and motor cars for expatriate employees of international business enterprises living and working in Cyprus
- Low set-up and operating costs
- Highly qualified managerial, clerical and technical staff available, in conjunction with the low cost, by international comparison, of the services provided
- Sound industrial relations between the social partners
- High quality of life, in conjunction with comparatively low prices ¹¹.

i) Serving as entrepreneurial base for the Middle East region...

Cyprus has served and can continue to serve as a base for foreign companies interested in taking advantage of business opportunities in the Middle East. Such companies could benefit from the strategic geographical location of the island, the friendly relations with almost all the countries of the region, and the Cypriot knowledge of these markets¹².

Cyprus' role as a regional commercial and business centre is strongly supported by its communications infrastructure. Business can benefit from the wide network of air-routes offering excellent connections with Europe, Africa, and Asia as well as from the multi-purpose ports which serve as gateways for seaborne cargo and passenger traffic. Last but not least, Cyprus enjoys an advanced road system with 4-lane highways linking all central destinations. However, it has to be mentioned that the public transportation system between cities, such as Nicosia – Larnaca, or Nicosia – Limassol, remains an unsolved issue as there is no appropriate infrastructure. This aspect is especially important taking into consideration that there is left-sided traffic in Cyprus which may deter some visitors from renting a car.

j) Introducing the institution of Business Incubators ...

Business Incubators provide the necessary support to new inventors in developing and marketing their innovative ideas and/or products.

Business incubators offer the following basic services:

¹¹ *Why Cyprus?*, Central Bank of Cyprus, http://www.centralbank.gov.cy/nqcontent.cfm?a_id=37;

¹² *The Challenges of the Cypriot economy in the process of accession to the EU*, Presentation by Mr. Antonis Malaos, Director of the EIC at the Summer School on "The Future of Europe", September 2002, <http://www.eic.ac.cy/EN/PaperMalaosSep02.htm>

- Help in determining whether the idea can be implemented from a technological and commercial point of view
- Help in designing the plan for research and development
- Secretarial and accounting support
- Scientific and consulting support
- Help in finding the appropriate financing

2.2. MACROECONOMIC CHALLENGES

Despite its macroeconomic stability, Cyprus could not stay unaffected by the global uncertainties impacting on the world economy. As for the rest of the EU, booming oil prices, the increasing trade gap, unsatisfactory investments and weakening of the industrial sector were the main adverse effects on Cyprus' economy in 2004¹³. Another important factor is the division of the island into the Greek and Turkish areas. As a consequence there is a significant difference in economic development between the Southern and Northern parts of the island. The Greek part is characterised by a more stable economic environment, while the Turkish part has higher inflation, higher prices and much lower wages.

After Cyprus' accession to the EU, its business environment has become more competitive thus prompting the need for higher productivity within enterprises.

The main short-term challenges to be faced are the following:

a) To overcome an excessive dependence on tourism

Tourism is without a doubt the most important driver of Cyprus' economic growth, but at the same time it is a particularly vulnerable and sensitive sector. Both tourism itself and all supporting services are significantly affected by external factors which result in substantial fluctuations of revenues and growth levels. The whole situation generates justified concerns for the government, which prepared the overall development strategy aiming at the strengthening of other sectors in order to diversify the economy towards new services and products beyond tourism, and fighting the excessive fragility of the economy. According to this plan the tourism "product" should be diversified in order to better suit the preferences of foreign consumers.

b) To assist in the revitalisation process of the manufacturing and industry sectors

The past decade has not been trouble-free for the manufacturing industry – it has had to face a drop in the growth of production, exports and employment originating from low competitiveness of the Cyprus economy. Moreover, the manufacturing sector's contribution to

¹³ Eurochambers, *National Report: Cyprus*, http://www.eurochambres.be/PDF/pdf_ees2005/Cyprus.pdf

national GDP is decreasing. The lack of competitive advantage is caused mainly by structural weaknesses in the sector, the drastic reduction of tariff protection due to the participation of Cyprus in the World Trade Organisation, rising labour costs and low productivity.

Furthermore, many companies (for example operating in the textile industry) are being closed or delocalised - mainly to Romania, Jordan, Egypt, Syria, Croatia and Bulgaria - in order to minimise costs of production. *It cannot yet be categorised as a delocalisation process, but some companies have started to turn to this solution. Potentially this may become an important phenomenon if labour costs remain high and there is a sustained low intake of third country workers.*

Structural weaknesses of the manufacturing industry are the following:

- Limited capacity for modernisation and improvement
- Very small size of companies and limited scope of collaboration
- Disproportionate dependence on the internal market
- Relatively high labour cost¹⁴
- In cases, relatively low use of modern technologies
- Variable effectiveness of systems of organisation and management

The steps and measures taken by the government in order to overcome problems that have arisen include:

- Attraction and development of new high-tech industries
- Assistance to and reconstruction of Cyprus' traditional industry
- Aim to increase productivity
- Attraction of foreign investment
- Variety of community programmes and structural funds designed for SMEs¹⁵.

c) To enhance competitiveness and productivity

The average small size of companies (99.9% employ fewer than 250 persons, 95% employ fewer than 10 persons and the average number of people employed was 4,4 per unit in 2000) hinders the exploitation of economies of scale and the adoption of advanced technologies and modern methods of management, production design and marketing, training and upgrading of human resources.

Relatively low productivity in the production sector is caused by bigger increases in Cyprus' production costs in comparison with its competitors, with whom competition has intensified following the implementation of the Customs Union Agreement between Cyprus and the EU, the island's accession to the EU zone and finally the increasing liberalisation of world trade, all

¹⁴ It is important to note that there is no joint approach of the social partners as far as the definition of labour cost is concerned.

¹⁵ <http://www.cyprus.gov.cy/cyphome/GovHome.nsf/LookupIDs/38933BBC83EC7298C2256B6B002FC8AD?OpenDocument&languageNo=1>, 27 February 2005

in conjunction with inadequate efforts to adapt to the new environment¹⁶. In the services segment – especially tourism – quite low competitiveness levels can be related to relatively high price levels in comparison to the other Mediterranean countries, as well as inadequate infrastructure. Summing up, in order to achieve a satisfactory level of competitiveness and productivity the manufacturing sector needs technological upgrading.

The strategic objective of Cyprus is to enhance the qualitative dimension of competitiveness, through the development and implementation of high value added activities, mainly technology and knowledge intensive ones. In parallel, there is a need for improvement of the price/cost ratio, through an increase in productivity and stabilisation in the rate of growth of production costs. The planned activity is grouped around 4 priority pillars:

- Improvement of the business environment
- Enhancement and modernisation of business activity
- Strengthening the outward orientation of the secondary and tertiary sectors
- Enhancement of research, technology and innovation¹⁷

d) To maintain the FDI level

In 2003 FDI into Cyprus (including investments from the EU) reached € 904 million, compared to a 2002 figure of € 1,114 million. This drop of 19% could be explained at the time by the anxieties of offshore operators with regard to the planned termination of the country's off-shore status upon entry into the EU. The complete disappearance of Cypriot off-shore activity is planned for 2005. Regulatory constraints, along with the size of the market, have not encouraged overseas investors to involve themselves with the onshore industries¹⁸.

e) To strike the trade balance

The island's trade balance traditionally represents a deficit that, to a large extent, is covered by "invisible resources", mainly tourism revenue. Cyprus is an open economy and the percentage of imports and exports of commodities and services amounted to 97% of GDP in 2001. On the production side the lack of raw materials, energy resources and heavy industry for the production of capital goods necessitates the importation of such goods. On the demand side, due to the small size of the domestic market, exports are vital in supplementing aggregate demand for Cypriot agricultural, mineral and manufacturing products.

In 2001 the trade deficit was equivalent to 28% of GDP, and in 2003 it decreased by 9,2%.

¹⁶ Executive Summary, *Strategic Development Plan 2002-2006*, <http://www.refernet.org.cy/download/Ex.Sum.Strat.Dev.Plan%2004-06.pdf>

¹⁷ Executive Summary, *Strategic Development Plan 2004-2006*, p.27, <http://www.refernet.org.cy/download/Ex.Sum.Strat.Dev.Plan%2004-06.pdf>

¹⁸ *Foreign Direct Investment into Cyprus in 2003*, Euro-Mediterranean Network of Investment Promotion Agencies, 25 October 2004, http://www.animaweb.org/news_en.php?id_news=196

One of the basic reasons for the deficit is the low competitiveness of Cyprus' products. For data on trade balance as a % of GDP, see Graph 3 in Annex 1.

f) To attain balance in regional development

Disparities in the level of inter-regional development are still present in Cyprus. The “development hubs” are mostly concentrated in a few coastal areas and in the main urban centres. The less developed areas, where the per capita income is considerably lower as compared to the average, are characterised by the concentration of production in comparatively very low value added activities. Some areas, mainly in the hinterland, also fall behind in terms of physical infrastructure (e.g. road network), social services (e.g. health, education) and environmental infrastructure (e.g. sewage systems, landfills). The lack of an adequate transport system can also have adverse effects in terms of local unemployment. It is also important to bear in mind that the North-South division of the island is a challenge as far as regional development planning is concerned.

g) To establish Cyprus as an international information centre

The broad development of services and the existing potential for their diversification have opened new prospects with regard to the regional and international role of Cyprus. Special importance is given to new prospects resulting from developments in the information services sector. Owing to an advanced telecommunications network and the first-rate regional and global connectivity, Cyprus is regarded as one of the most important telecommunication hubs in the Eastern Mediterranean and Middle East regions. This is supported by an extensive submarine fibre optic cable network, and access to major satellite systems¹⁹.

h) To encourage R&D activities

In Cyprus, the research sector is not as developed as in other EU member states, as indicated by the level of expenditure as percentage of GDP which is below 0.5% in comparison to 2 - 4% of GDP in other EU countries. Therefore one of the medium-term economic policy priorities is to create and boost the knowledge-based economy. The European Innovation Scoreboard 2003 classified Cyprus as one of the “catching up” countries, given the high positive changes in trend indicators, and highlighted that “innovation diffusion” is more important to the economy than “R&D based innovation”.

¹⁹ *Investing in Cyprus: A guide for foreign investors*, The Foreign Investors Service Centre, Ministry of Commerce, Industry and Tourism of the Republic of Cyprus, 2004

The measures already undertaken include:

- Creation of the Institute for the Promotion of Research
- Participation in common European programmes
- Encouragement of co-operation among research agencies and enterprises
- Strengthening the research infrastructure with emphasis on the fields of information technology, energy, telecommunications, saving of water resources, environment

i) To reform the public sector

The problems in the public sector relate to low efficiency and high costs. Changes in the structure and the *modus operandi* of the public sector are necessary in order to improve efficiency and reduce unnecessary bureaucracy as well as to create a “business friendly environment”.

The following steps are recommended:

- Simplification of procedures and decentralisation of functions
- Promotion of education and training programmes with emphasis on the management and information sectors
- Revision of the evaluation system of civil servants
- Introduction of incentives in combination with the efficiency of labour
- Encouragement of more independence at the decision-making levels
- Releasing the State from the provision of services which can be offered more efficiently by the market and focusing on its regulatory role
- Acceleration of computerisation of activities according to a programme of priority needs²⁰.

Source: *The challenges of Cypriot economy in the process of accession to the EU*, Presentation by Mr. Antonis Malaos, Director of EIC at the Summer school on ‘The future Europe’, September 2002

Public sector efficiency could be also increased by converting public utilities (companies) into private shares companies. Social partners stress that there is an imbalance between the public and private sectors, especially as far as security and wages are concerned.

The Strategic Development Plan for the years 2003-2006, in its SWOT analysis of the Cyprus economy, puts emphasis on the following factors that will influence the growth of economy in the nearest future²¹:

Strengths	Weaknesses
Healthy and dynamic economy based on market mechanisms.	Deficiencies compared to the advanced economies with respect to the level of productivity due to insufficient use of modern technology.
Flexible economy, capable of adapting to changing conditions.	Problems of competitiveness, especially in the manufacturing and agriculture sectors.
The remaining rigidities, limited in number, in the effective functioning of the market mechanism were to be abolished at the latest upon accession	Weaknesses in the structure of investment, with the share of mechanical equipment relative to total investment fluctuating at much lower levels

²⁰ *The challenges of Cypriot economy in the process of accession to the EU*, Presentation by Mr. Antonis Malaos, Director of EIC at the Summer school on ‘The future Europe’, September 2002

²¹ Executive Summary, Strategic Development Plan 2004-2006, p.10-11,
<http://www.refernet.org.cy/download/Ex.Sum.Strat.Dev.Plan%2004-06.pdf>

to the EU.	compared to advanced economies.
Satisfactory level of growth compared to the EU average (per capita GDP in purchasing power standards, 76% of the EU average in 2000).	Partial dependence on tourism, which is particularly vulnerable to external and unpredictable factors.
Intermittently very satisfactory rate of economic growth (average annual growth rate 5,2% for the entire period from independence to date).	Small size of enterprises and limited degree of synergy between them.
Satisfactory level of savings, allowing growth to be financed largely from national sources.	Small domestic market.
Full employment conditions. The unemployment rate fluctuates at very low levels: 3% in 2001, 3,2% in 2002.	Scarcity of natural resources, including water, raw materials and limited capacity of beaches.
Conditions of relative macroeconomic stability, low inflation and, generally, low current account deficit.	Significant stress on the environment and largely unsatisfied needs in environmental works and actions.
Tax system with low (by international comparison) tax rates, both for legal and for natural persons, which encourages business activity and employment.	Very low levels of expenditure on research and development (around 0,25% of GDP), as compared to other European countries (around 2%).
Favourable business climate.	Imbalances in regional economic development.
Well-educated labour force (32% of the total gainfully employed population are tertiary education graduates).	Quantitative and qualitative imbalances in the labour market, especially in the sectors of hotels and restaurants, wholesale and retail trade and construction. At the occupational level, shortages in technical and semi-skilled occupations.
Relatively satisfactory infrastructure in transport, energy and telecommunications.	
Cyprus constitutes an attractive international business centre due to its comparative advantages.	
Prevalence of cooperative industrials and social cohesion conditions.	
Opportunities	Threats / Challenges
Unhindered access of Cypriot goods and services to the large single market of the European Union.	Increased competition as a result of Cyprus' accession to the EU,
Increased confidence and enhanced prospects linked to accession to the EU.	Potential problems in the long-term viability of the social insurance scheme due to the ageing of population.
Potential for greater exploitation of the island's strategic geographical location as an outpost of the EU in conjunction with its close economic and political relations with the other countries in the region.	
Benefits for all sectors of economic activity and the consumers resulting from the liberalisation of the public utilities sectors.	
Potential for a more balanced regional development, in view also of the utilisation of the EU' s structural actions.	
Potential for rapid productivity growth and	

convergence with the EU average via the introduction of technology, innovation, know-how.	
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2.3. LABOUR MARKET & EMPLOYMENT CHALLENGES

Fast economic growth over recent years, described in the previous section, has been accompanied by job creation and a satisfactory increase in employment. Cyprus is well on track to exceed the Lisbon (2010) employment targets: total employment rate of 70% and the proportion of women in employment of 60%. At present, Cyprus practically enjoys full employment conditions – the overall employment rate in 2003 amounted to 69,4% (EU average: 63.0%) and is expected to rise by 1,2% in 2005²² while female employment in 2003 reached 60,4% (EU average: 55.1%) compared with 59,0% in 2002.²³ At the same time unemployment increased slightly to 4.4 % in 2003; however, it remains significantly below the EU average of 9.1 %. In 2003, long-term unemployment increased marginally to 1.1 % (EU average: 4.0%) but still remained low. A Cypriot member of UNICE states that at present the official unemployment rate is 3,8%, but the long-term unemployment rate stands at 0,8%. “This is caused by the fact that people register as unemployed to get the unemployment benefits even if they have already a new job arranged or retire early at the age, let’s say 62-63 when they get the pension from the employer and not from the state”- the representative goes on to explain.

According to the Labour Force Survey of 2003 carried out by the Statistical Service, the labour force, i.e. the economically active population, amounted to 341.203 persons: 55% males and 45% females. The number of employed persons was 327 094 in 2003 and it comprised of:

- 78,8% of men (same as in 2002)
- 60,2% of women (59,0% in 2002)
- 50,2% of persons aged 55-64.

Cyprus’ excellent performance towards achieving Lisbon Strategy goals (towards 2010) is presented in Table 1 at Annex 1.

The overwhelming trend in the whole economy is the rising role of the tertiary sector as the main employer. The services sector accounts for approximately 72% of the workforce (and almost 85% of women in employment), while the industry and manufacturing accounts for 22.7% and the agriculture sector 5.3%. The huge expansion of the tertiary sector from the point of view of employment resulted both from job creation and the migration of labour from the primary and secondary sectors.

²² *Convergence Programme of the Republic of Cyprus 2004-2008*, Ministry of Finance of the Republic of Cyprus, December 2004, [http://www.mof.gov.cy/mof/MOF.nsf/4208432071A9E967C2256F660045AC5A/\\$FILE/CP2004_2008_Final_appendix.doc](http://www.mof.gov.cy/mof/MOF.nsf/4208432071A9E967C2256F660045AC5A/$FILE/CP2004_2008_Final_appendix.doc)

²³ <http://www.eu-coordinator.gov.cy/Harmonization/Harmonization.nsf/0/82137E7166788954C2256F970028EE96?OpenDocument>

Employment by sector of economic activity **	1980	1990	2000	2001	2002	2003
Primary Sector	20,5	14,0	8,5	8,2	8,0	7,8
Secondary Sector	33,7	28,8	21,4	21,0	21,0	20,8
Tertiary sector	45,8	57,2	70,1	70,8	71,0	71,4

Source: National Action Plan for Employment 2004-2006, Republic of Cyprus, Ministry of Labour and Social Insurance, July 2003

http://www.europa.eu.int/comm/employment_social/employment_strategy/nap_2004/nap2004cy_en.pdf

In order to improve productivity and competitiveness special emphasis must be put on the quality and flexibility of the workforce together with an increase of the innovation capacity of industry and further diversification of the service sector. Thus, the biggest long term challenge to be faced is the problem of upgrading skills and knowledge of personnel while the most pressing problem is to lower labour costs and improve labour market flexibility. Some of the Cypriot social partners share the position that a more flexible immigration strategy may enable to fill vacancies with migrant workers when the internal supply of labour is insufficient.

Increasing competition stimulates demand for the labour force. As a consequence the long term challenge is to guarantee that there are enough workers to meet the supply of work. At the moment the Cypriot labour market is starting to face the problem of labour force shortages; it especially concerns “blue collar” workers and people who could work in the service sector. This issue should be tackled as soon as possible to prevent Cyprus from losing competitiveness. Some of the Cypriot social partners stand in the position that a more flexible immigration policy may enable to fill in vacancy positions by migrant workers in cases when the internal supply of labour is not sufficient.

a) Introduction of flexible work practices into the system

In Cyprus, new forms of work organization are still in the first stages of development and this is still not a major subject on the social partners’ agenda. Employers’ organisations support introducing and promoting new forms of employment that combine flexibility and security of employment. These practices include: part-time work, telework, fixed-term work, subcontracting, right to outsourcing and transnational activities. They exist in the legal system, but are not used in practice on an everyday basis, partly because of Trade Unions’ negative attitude towards them – the unions have expressed concern over the possibility that part-time employment may increase at the expense of full-time employment²⁴. “We are for part-time work and we welcomed the transposition of the Directive 97/81/EC on part-time employment, but we fear that other forms, e.g. fixed-term contracts, may make employees slaves of an

²⁴ 2003 Annual Review for Cyprus, <http://www.eiro.eurofound.ie/2004/01/feature/cy0401102f.html>

employer and they do not guarantee the employee rights” – a representative of one of the Cypriot trade unions says.

In 2003 part-time workers accounted for 8,9% of the total number of employees, and only 9,6% of all workers are employed on fixed term contracts²⁵. In the same year about 29.000 employees (8,9%) were working on a part-time basis, compared to 7,2% in 2002. What is important, 60% of them said that “they did not want a full-time job” and 21% stated that “they could not find a full-time job”. Almost 23.000 employed persons (7%) had a second job (most of them - about 47% - in the agricultural sector).

Flexible methods of work organisation may also be introduced in order to attract workers who do not want to or cannot work in a traditional way.

b) Coherent and comprehensive strategy towards immigrant workers

As unemployment is very low, finding an “*appropriate and available workforce*” can be a problem for many companies that are affected by skills shortages. To maintain a high level of economic development, in-migration of workers is necessary, especially in the manufacturing, construction and agriculture sectors. These jobs are eagerly accepted by foreign workers who settle in Cyprus in search of good jobs and good money. Work permits are normally issued to foreigners upon the request of the employer only when no suitably qualified staff are available locally or from the EU member states and candidate countries. In most cases, immigrant workers are employed in “*manual, unskilled, low-paid and low-prestige jobs in which Cypriots show no interest*”. Additionally, a large number of them perform “atypical” work, mainly of a seasonal nature, or are employed in extremely difficult conditions. However, employers’ representatives do not agree with this observation stating that numerous inspections carried out by the Ministry of Labour and Social Insurance make sure the employers abide by the relevant laws and that there is an equal treatment of immigrant workers. They also support the view that illegal workers should be tracked down and deported immediately.

“A particularly problematic sector is the “sex industry”, which includes part of the category of “performing artists”: on the whole, these are women who work mainly in nightclubs and cabarets. This is a problematic sector where “slave-trade” conditions prevail, labour and social insurance legislation is severely violated and control mechanisms are non-existent”²⁶. During the last 10-15 years a significant inflow of foreign workers into the island’s economy (in every domain) could be observed. In 2003 foreign workers accounted for 11.7% of the total workforce²⁷ - 56,7% of them were citizens of third countries, 33,4% were citizens of EU15

²⁵ National Action Plan for Employment 2004-2006, Republic of Cyprus, Ministry of Labour and Social Insurance, July 2003)

http://www.europa.eu.int/comm/employment_social/employment_strategy/nap_2004/nap2004cy_en.pdf

²⁶ Migrant workers and industrial relations, <http://www.eiro.eurofound.ie/2003/11/feature/cy0311103f.html>

²⁷ Labour Market Situation, Department of Labour, Ministry of Labour and Social Security of the Republic of Cyprus,

member states, 9,2% were Bulgarian and Romanian citizens, while 0,7% were citizens from the former EU accession countries (now the new Member States). It is important to note that the employment of EU nationals and nationals of Romania and Bulgaria is strongly encouraged in the first instance.

During a 3-year period, between 2000 – 2003, the number of foreign workers in Cyprus increased by 17,9% annually. This relaxed official immigration policy ended in 2004, when, due to EU accession, the government had to take a more strict position towards foreign workers. It is estimated that the percentage of employed foreign workers will remain at around the same levels for the 2004 – 2007 period and reach 12,7% in 2007²⁸. This could turn out to be too low, and because of this, employers worried about further growth of productivity vote for more moderate legal regulations concerning employment of the foreign workers.

The position of trade unions has evolved gradually from “defensive” during the 90s to more positive, albeit cautious, and they stressed the need to reduce the numbers of foreign workers in parallel with the need for their full integration into work and into society²⁹. One of the trade unions observes an inflow of seasonal workers in Northern Cyprus from Anatolia in Turkey who come with their ID cards and do not need a work permit. These workers are rather low-skilled workers, whereas there is instead a big demand for people with technical skills. Additionally, they accept to work in very poor conditions, lowering the standard of working conditions. The proposed solution would be to introduce work permits and mandatory registration at the Labour office which would enable to monitor the scale of the workers’ inflow. Moreover, trade unions believe that work permits should be obtained by employees and are keen on the present immigration policy. At the same time approx. 8 000 Turkish Cypriots have been working in the Greek sector for the last 2 years.

Immigrants’ presence in Cyprus is dealt with as a temporary phenomenon, and no efforts are made towards their active participation and full integration in the country’s labour market and social life. In brief, three basic problems have been identified:

- the absence of integrated, long-term planning, emanating from the erroneous assumption that immigrant workers’ residence will be short-lived
- deficiencies on the legislative and institutional levels and the lack of control mechanisms with regard to the implementation and observance of the terms and conditions of employment, resulting in systematic discrimination against immigrants, both at work and in society as a whole
- a lack of political will regarding the full integration on an equal footing of immigrants in Cypriot society, on the basis of the principles of diversity, multiculturalism and social solidarity³⁰.

Employers’ representatives stress that this is not the case with legally employed workers.

c) Reducing labour force shortages

<http://europa.eu.int/eures/main.jsp?catId=2751&acro=Imi&lang=en&recordLang=en&parentId=&countryId=CY®Id=CYNAT&mode=text>

²⁸ National Action Plan for Employment 2004-2006, Republic of Cyprus, Ministry of Labour and Social Insurance, July 2003) http://www.europa.eu.int/comm/employment_social/employment_strategy/nap_2004/nap2004cy_en.pdf

²⁹ Migrant workers and industrial relations, <http://www.eiro.eurofound.ie/2003/11/feature/cy0311103f.html>

³⁰ Migrant workers and industrial relations, <http://www.eiro.eurofound.ie/2003/11/feature/cy0311103f.html>

Nowadays, except for engineers, the most frequent demand in the Cypriot labour market is for low-skilled workers: metal workers, plant and electronic equipment personnel, plant operators and assemblers, salespersons and customer service personnel, waiters, waitresses and bartenders, workers in the agricultural and manufacturing sectors – generally low-skilled workers or workers for low-skill jobs³¹. Each year there are fewer and fewer candidates for “blue collars” jobs as the education level of the Cypriot labour force increases. Additionally, Cyprus enjoys almost full employment conditions, which implies that considerable work force shortages can occur faster than expected. The only way to prevent this or at least to minimise its effects, and in this way to avoid economic slacking, is to open the door to immigrant workers.

Data on employment and labour force by level of education in 2003 can be found in Table 2 at Annex 1.

d) Minimum wage legislation

The minimum wage was originally introduced in 1941 in order to avoid post-war poverty. Today though, Cyprus has no statutory national minimum wage, but the Law on Minimum Wage Levels provides for minimum salaries and wages to be set for six occupations. These are: sales staff, clerical workers, auxiliary healthcare staff and auxiliary staff in nursery schools, crèches and schools - 6 occupations characterised by the lowest unionisation levels by occupation. It is intended that wages of individuals (mostly women) who are employed in these professions will be increased. There is a minimum wage which applies upon recruitment and another which applies six months later for those who remain with the same employer. In 2005, the minimum wage was € 620 / month (first 6 months of work) and € 655 / month (after 6 months), and by 2008 it is planned to increase to € 800 / month (50% of the median salary). The projected increases in the minimum wage raise national disputes: *“the employers’ organisations argue that wage minima should be abolished and that wages should be frozen, particularly in view of the fluid political situation. The unions, on the other hand, argue that the coverage of the policy should be extended to include other workers such as security guards and cleaning personnel”*³². Another argument raised by employers is that the particularly high level of unionisation in Cyprus (almost 70%) has made it needless to continue with the practice, which among other effects distorts the system of collective bargaining, since it pushes minimum wages, freely agreed in collective agreements, upwards³³. The employers’ representatives feel that the minimum wages in their present shape do not correspond to the productivity indicators. There are also fears that if applied, minimum wage increases may impact unfavourably on legal employment, increase illegal employment and possibly add to

³¹ <http://europa.eu.int/eures/main.jsp?catId=2751&acro=Imi&lang=en&recordLang=en&parentId=&countryId=CY®ionId=CY-NAT&mode=shortages>

³² www.eu-employment-observatory.net/resources/monthlyupdates0405/cyprus_update_may_04.doc

³³ Minimum wage increase for six occupations, <http://www.eiro.eurofound.ie/2004/05/inbrief/cy0405101n.html>

the number of unemployed local workers. Trade unions believe that the existing system should be kept in place and are willing to negotiate possible steps that could make the system better fit the present economic environment. Independently of the solution, the minimum wage should be secured at a decent level.

e) Wage formation mechanism

Cyprus' competitiveness is also influenced by the system of wage formation and there is a really strong demand, on the side of employers organisations, for its reform. They criticise the system for undermining flexibility and competitiveness and for not responding to real increases in productivity in specific sectors or individual companies, and they call for opening the social dialogue on these issues. On the other hand, the *“COLA system has proved to be a catalytic factor in ensuring the signing of long-term collective agreements, which has the effect of ensuring industrial peace”*.³⁴

Generally speaking, the Cypriot wage formation system consists of 3 elements:

- Basic salary – determined through collective bargaining;
- Cost-of-living allowances (COLA) – direct and immediate compensation of inflation, paid every 6 months (on January, 1 and July, 1) directly by the employer. In the private sector it is based on collective agreements (although they are not legally binding they are *“observed strictly and with no exceptions”*) and in the public sector at large (public sector, local authorities, public utilities) it is regulated by law. It is important to note that the COLA system was an important security factor in times of macroeconomic instability, but today it is abolished in all European countries; in the Northern part of Cyprus COLA is paid every 2 months due to the high inflation rate;
- Increment, a wage/salary scale paid automatically once a year (public sector, banks) based on the collective bargaining results (3-3,5% of the previous salary/wage). It does not apply to all sectors of the economy.

The obligatory increase of salary amounts to about 6% annually (an employers' organisation representative estimates it to be as high as 7-8%) while productivity growth is equal to 2,5%. In January 2005 the increase of the basic salary was 8,59% and the increase of the gross salary 2,51%. It has to be highlighted that the wage formation system has recently led both to high nominal wage increases and unit labour cost increases that are higher than in competing

³⁴ Social dialogue and EMU in Cyprus, p.67, www.eurofound.eu.int/industrial/social-dialogue/EF0388EN%20chapter%201.pdf

countries, resulting in the deterioration of the competitiveness of Cypriot goods and services on both domestic and external markets³⁵.

In general trade unions are in favour of the existing wage formation mechanism. They believe that the COLA system should be maintained, but are willing to discuss possible alterations that could better match the present economic situation of the country. Trade unions evoke the example of the COLA reform which resulted in removing tobacco, petrol and alcohol from the COLA system. Whilst willing to discuss possible changes in the wage formation mechanism, trade unions are strongly against wage freezes.

f) Promoting gender equality

Equal opportunities is a subject of debate in Cyprus. In general, women have a lower employment rate than men and a higher unemployment rate, and are more likely to work part-time or on a temporary basis, while their average pay is lower than it is for men.

The gap between the numbers of employed men and women in Cyprus is greater than in most of the EU15 Member States. According to Labour Force Survey data, in 2002 the overall employment rate (ie the number of employed people aged 15-64 as a percentage of the whole population aged 15-64) in Cyprus was 68.5% (up from 67.9% in 2001). The rate for men was 78.8% (down from 79.4% in 2001) and for women 59% (up from 57.1% in 2001). For the group aged 25-54, in 2002 the employment rate was 93.2% for men and 72% for women (and 82.2% in total). The overall unemployment rate was 3.4% in 2000, falling to 2.9% in 2001. Unemployment rates for men fell from 2.7% to 2.3% and for women from 4.4% to 3.8%. Some 47% of unemployed women were aged 30-50, and 27% were aged under 29³⁶.

However, in recent times the structure of the employed population has demonstrated a small, but steady increase in the number of working women. During the period 1995-2001, the presence of women in the labour market showed a stable increase, mainly in the services sector and in unskilled work. What has to be highlighted is that women prevail as part-time workers and temporary workers. The situation is different with respect to self-employment and holders of a second job. In both cases, men constitute a significant majority. It can be explained by the fact that *“in a society like Cyprus, where traditional, deeply-rooted values and stereotypes regarding the genders and their roles insist that the man is still the head of family, the securing of a second job by men is not surprising. It is possible that men taking second jobs results in a widening of the wage gap to the detriment of women, and also proves unhelpful to women in improving the gender distribution of work within the family”*³⁷.

³⁵ Cyprus—2004 Article IV Consultation, Preliminary Conclusions of the Mission, International Monetary Fund, 2004, <http://www.imf.org/external/np/ms/2004/102904.htm>

³⁶ Equal opportunities and industrial relations, <http://www.eiro.eurofound.ie/print/2004/01/feature/cy0401103f.html>

³⁷ Equal opportunities and industrial relations, <http://www.eiro.eurofound.ie/print/2004/01/feature/cy0401103f.html>

With reference to the gender wage gap, in 2001 men were paid on average 34.9% more than women while women received lower pay on average than men in all main occupational categories. In conclusion it can be stated that, in spite of the increased number of women in the labour market and the “evolution” in the “patriarchal” structure of employment, the general situation of women is particularly disadvantageous vis-à-vis that of men: the female employment rate lags behind the male one, their unemployment rate is almost double, and women prefer or are preferred in positions of flexible employment and constitute the majority of unpaid workers in family enterprises. At the same time, they are over-represented in low-skilled jobs, and they hold a considerable number of jobs in the “grey economy” (especially female migrant workers employed as domestic workers or working in the so-called “sex industry”).

g) Strengthening social cohesion and inclusion

Economic inequality, poverty, and social exclusion may not, in general, be regarded as highly sensitive issues in Cyprus. Nevertheless, in recent years, the number of recipients of public assistance has been steadily rising. They consist mainly of the elderly, people with disabilities, single-parent families and families whose ‘heads’ have a low level of education. A significant challenge in the nearest future is the phenomenon of demographic ageing. Although demographic ageing is not alarming, it is becoming visible. There are clear signals that it will become an issue of concern in the next two decades with far-reaching implications.

Persons over 65 years of age comprise 11,4% of the total population. The fertility rate is already below replacement level (2000: 1,8%) and by the year 2028, low fertility and mortality rates are expected to lead to a sharp increase of the older population, projected to reach almost 17,6% of the total population. The group of people aged 80 years and over is expected to double³⁸.

h) Intensive investment in human capital development and lifelong learning

The labour force constitutes the most important factor of production for the island’s economy and consequently, measures aiming at its proper management, development and upgrading are of special importance. The first element that adds to that objective is the permanent improvement of the quality of education and the flexibility of the educational system at all levels so as to ensure that it meets labour market needs effectively.

³⁸ Statement of H. E. Mr. Andreas Moushountas Minister of Labour and Social Insurance at the Second World Assembly on Ageing, Madrid, Spain, 9th April 2002 , <http://www.un.org/ageing/coverage/cyprusE.htm>

The level of education of the Cypriot population has continued to rise over the past decades and today the situation regarding primary, secondary and higher education is more than satisfactory.

- The percentage of persons between the ages of 20 and 24 that have completed the Lyceum (upper secondary education) is 79,5%, which is higher than the EU average, (75,5%) but lower than the European Employment Strategy (EES) target (85%) by 2010.
- The net participation rate in education for young persons of 12 - 17 years old is estimated at 90%.
- In the academic year 2002-2003, 64% of secondary education graduates continued their studies in tertiary education (23% in Cyprus, 41% abroad - in Greece (53%), the UK (23%) and the USA (14%)³⁹.
- 17,4% are early school leavers (higher rate for boys), which is slightly lower than the EU average (18,8%) but higher than the EES target of 10%.
- The participation rate in secondary technical/vocational education is lower, particularly amongst girls.
- 32,4% of the labour force has completed higher education, compared to the EU average of 24,2%.
- 7,9% (LFS) of persons aged 25 – 64 participate in education or training, a rate which is lower than the EU average (8,5%) and the EES target for 2010 (12,5%).
- In 2002 public expenditure on education as a percentage of the GDP increased to 6,9%, compared to 6,3% in 2001⁴⁰.

The urgent issue that needs to be resolved remains vocational and lifelong training, especially strengthening and upgrading of training and retraining structures. There are three main targets to cover: entrepreneurs, managerial staff and vulnerable social groups. Training programs addressed to managers and higher staff are oriented at helping them to adopt and implement modern and innovative methods and practices in the areas of management, administration and production. At the same time programs directed at young people, newcomers (immigrants or labour market entrants), the unemployed, the inactive female labour force, and the repatriates, are meant to improve and strengthen their position at the labour market.

▪ **Human Resources Development Authority**

The main institution responsible for vocational education and training activities is the Human Resources Development Authority (HRDA)⁴¹. In its daily work HRDA assures the continuous assessment of labour market supply and demand and the formulation of strategies to meet the learning needs of individuals in employment and of those seeking employment, and to listen to the needs of employers. The Authority employs 120-130 experts and from January 2006 its activity is to be financed with the help of the European Social Fund.

HRDA is responsible for conducting training needs analysis at the enterprise level, designing training programmes and delivering such programmes at the Authority premises. The Authority's activities are financed from the employers' contribution which amounts to 0,5% of

³⁹ *Cyprus at A Glance*, Ministry of Foreign Affairs, <http://www.mfa.gov.cy/mfa/mfa.nsf/CyprusinaBrief?OpenForm>, 23.05.2005

⁴⁰ National Action Plan for Employment 2004-2006, Republic of Cyprus, Ministry of Labour and Social Insurance, July 2003, http://www.europa.eu.int/comm/employment_social/employment_strategy/nap_2004/nap2004cy_en.pdf

⁴¹ <http://www.hrdauth.org.cy/hrdav1en/>

the payroll. The employers' representatives perceive this fund as a very useful mechanism and intend to maintain its operation in the present form.

i) Stimulating entrepreneurship

Strengthening entrepreneurship policy is promoted in the context of enhancing the competitiveness of the economy. It is based on two pillars: improvement of the business environment and strengthening and modernisation of business activities. Particular interest is given to "Youth entrepreneurship" – the aid program focuses on the development, assistance, and endorsement of entrepreneurship of young people (both men and women) and SMEs *"with the provision of financial aid and training courses for the creation of new modern and viable enterprises"*⁴², that are believed to constitute the main source of and drive for further economic development. Special stress is put on the use of new, innovative technologies, methods of production and the promotion of products and services. One of the employers' representatives stresses that in order to stimulate entrepreneurship, working hours in the retail sector should be extended, especially while taking into consideration that Cyprus has the ambition to remain one of the major tourist destinations.

Trade unions recognise the need to stimulate entrepreneurship, but stress the need to protect employee rights at the same time. They see the importance of introducing new ways of working and opt for part-time work which is already regulated by a European Directive, but are against introducing fixed-term contracts. The same concerns improving productivity indicators: this issue should be discussed by the social partners in depth, in parallel with discussions on the COLA system.

⁴² *National Action Plan for Employment 2004-2006*, Republic of Cyprus, Ministry of Labour and Social Insurance, July 2003, http://www.europa.eu.int/comm/employment_social/employment_strategy/nap_2004/nap2004cy_en.pdf, p. 15

III. RESTRUCTURING CHALLENGES

This section:



presents the Cypriot social partners understanding of the restructuring phenomenon,



presents the Redundancy Fund mechanism, and



presents the Cyprus Airlines restructuring case study.

▪ **What is restructuring?**

According to the UNICE member, *“In Cyprus there are no talks about ‘restructuring’ as is the case in Poland or other post-Soviet block countries. By contrast, terms such as: ‘change’, ‘adaptation to the EU, ‘modernization’ or ‘tuning to the economy needs’ are in every day use.”* The ETUC member states *“Restructuring is a phenomenon that affects not only enterprises, but also living and working conditions of the labour force. Restructuring is not purely an economic issue, but has its social consequences and this is why the two have to be taken into consideration”.*

In the opinion of the UEAMPE member, *“Restructuring means all types of changes of the labour market to become more flexible and which guarantee that the enterprises become more competitive”.*

A well developed, deeply rooted and mature social dialogue enables relatively peaceful negotiations during the restructuring process at the enterprise or sectoral level.

Cypriot trade unions have 3 principles concerning every process of restructuring, especially employment restructuring:

- Voluntary redundancies accompanied by a compensation package (this solution can be seen in the Cyprus Airlines case – 130 persons left voluntarily, 5 persons were fired);
- Seniority principle (“First in, last out”); applicable if written in collective agreements, only a few case;
- Family status and situation are to be taken into account while making the decision about redundancy.

▪ **Redundancy Fund**

Employees who become redundant are entitled to compensation from the Redundancy Fund. The amount of redundancy payment depends on the duration of employment and the earnings of the newly redundant employee. In 2004 the highest possible payment for a dismissed employee amounted to € 40,000. The compensation from Redundancy Fund serves to sustain the standard of living before finding another job or as initial funding towards self-employment. The Redundancy Fund is wholly financed by contributions from employers. The rate of the employer's contribution is 1,2% of the employee's earnings. At the moment it constitutes approximately € 200 million in total reserves. Employers postulate this should be reduced to 0,6% of the payroll and in this way it would unfreeze significant amounts of capital. They are willing to come back to the present level of contribution in case of insufficient funds, but they believe that at the moment it would be better to make use of the reserves and invest the saved 0,6% of the payroll in the enterprise development. According to a trade union representative, the Redundancy Fund should be kept at its present level; the only issue for possible negotiation is the way the Redundancy Fund should be spent.

▪ **Cyprus Airlines restructuring process**

Recently in Cyprus there was one significant case of restructuring – Cyprus Airlines. It started in August 2004, when the Board of Directors of Cyprus Airways submitted an action plan for the company's survival and restructuring. It was followed by a proposal aimed at ensuring its continued existence and operation, submitted by the Cypriot Ministry of Labour in November 2004. Additionally, in May 2005, the European Union approved the 51 million Euro loan guarantee, giving the airline six months to conduct the necessary restructuring process. The plans included the elimination of dozens of jobs, a pay freeze and cuts in pay supplements, changes in working time for some staff as well as downsizing the airline's fleet and shedding its loss-making Greek subsidiary Hellas Jet.

Originally, Trade Unions put forward counterarguments based on the belief that the plan was *"lopsided"* and the *"employees were to shoulder the burden of the measures to address most of the financial problems"*⁴³. Furthermore they did not accept staff redundancies caused by services outsourcing and proposed the implementation of an early retirement scheme. Finally, an agreement was reached in December 2004, it incorporated some proposals from the Board of Directors' proposal as well as some of the Ministry's proposal. As a consequence 130 employees left the company voluntarily, taking advantage of Redundancy Fund enriched with additional compensation packages paid by the employer – "The compensation package was

⁴³ *Cyprus Airways submits survival and restructuring plan*, <http://www.eiro.eurofound.eu.int/2004/10/feature/cy0410102f.html>; see also: *Ministry proposes survival plan for Cyprus Airways*, <http://www.eiro.eurofound.eu.int/2005/01/feature/cy0501103f.html>

very generous” the trade union representative involved in the process says. Only 5 employees were fired.

As a result of this restructuring process the performance of the company has improved, but there are still some problems with the profitability issues. “The decisions in the case of Cyprus Airlines have not always been reasonable and taken on economic grounds. Sometimes they were quite surprising.” – one of the interlocutors said. At the moment 82% of the company belongs to the government, but the enterprise is subject to private law.

IV. SOCIAL DIALOGUE

This section:



emphasises peaceful labour relations in Cyprus,



sheds light on the social dialogue in the northern part of Cyprus, and



lists issues considered important by the Cypriot social partners.

a) Peaceful relations and clear principles

Cyprus is considered to be a country of peaceful labour relations. The system is mature, well-established and well-developed. It is characterized by tripartite cooperation, freedom of speech, social dialogue and collective bargaining. The overall objective of the administration is to promote and encourage strong employers' and employees' organisations, with the intention of achieving a balance of power between the two sides.⁴⁴ The government's role is only consultative and it can be performed through the Mediation Service of the Ministry of Labour – mainly in difficult cases when achieving agreement in direct bipartite bargaining between employers' organisations and trade unions is particularly problematic.⁴⁵

Cypriot tripartite dialogue bodies have authentic responsibilities and authorities although their function is only consultative. Any matter or subject pertaining to work, labour law, employment policy or any other programmes dealing with the labour market are discussed by the tripartite social dialogue bodies.

As mentioned above the policy of industrial relations is focused on the maintenance of good industrial relations and industrial peace. The objectives of industrial relations are the following:

- "Safeguarding of the freedom of association
- Encouragement of growth of strong worker and employer organisations, and the fostering of tripartite cooperation,
- Promotion of free collective bargaining as the main method for determining terms and conditions of employment,
- Provision of assistance for the prevention and settlement of labour disputes, within the interests of the public as a whole,
- Protection of vulnerable groups of workers (mainly non unionised), by determining their basic conditions of employment through legislation,
- Enforcement of the Trade Union Law, including the registration and supervision of employees and employers organisations,
- Provision of special services to the Hotel and Restaurant Industry, including enforcement of the relevant Law pertaining to the terms of service,
- Promotion and enforcement of Labour Law with the purpose of harmonization with the EU acquis, that creates a new legal framework for the protection of employee rights and determines minimum labour standards"⁴⁶.

⁴⁴ http://www.mlsi.gov.cy/mlsi/dlr/dlr.nsf/dmlhistory_en/dmlhistory_en?OpenDocument

⁴⁵ <http://www.eiro.eurofound.eu.int/2004/01/feature/cy0401102f.html>

⁴⁶ <http://www.cyprus.gov.cy/cyphome/govhome.nsf/LookupIDs/65E78C2D007A54D9C2256A7100399744?OpenDocument&languageNo=1>

Both of Cyprus' employers' organisations, as well as the trade unions, are well established and very experienced with effective organisational structures.

It is worth highlighting that the two types of organisations represent nearly the entire labour community of Cyprus – unionisation rates are considerably high, with between 67% - 70% of all employees in Cyprus having trade union membership – and almost all of the Cypriot business/entrepreneurial community are members of the two employers' organisations.

There are two employers' organisations in Cyprus:

- Employers and Industrialists Federation (OEB)
- Cyprus Chamber of Commerce and Industry (CCCI)

The main national, multi-sectoral workers' organisations are:

- Pancyprrian Federation of Labour (PEO)
- Cyprus Workers Confederation (SEK and Turk-SEN – ETUC member organisations)
- Democratic Labour Federation of Cyprus (DEOK)
- Pan-Cyprian Federation of Independent Trade Unions (POAS)⁴⁷.

Industrial relations are based on the Industrial Relations Code – a gentleman's agreement signed by the social partners in 1977. It thoroughly outlines the procedures to be applied in cases of conflict resolution for labour disputes. The Code provides separate procedures for the settlement of the two major categories of industrial disputes: disputes over interests and disputes over rights. Although the Code is a "soft-law" agreement, it is highly respected by the social partners. The adoption of the Code ensured that all parties concerned perceive themselves as partners and not as enemies.

The Code strongly confirms the mutual willingness of both participating sides to respect the four elementary rights:

- "Right to Organise
- Right to Collective Bargaining, Collective Agreements and Joint Consultation
- Definition of issues proper for collective bargaining, joint consultation and management prerogatives
- Affirmation of strict adherence to the provisions of International Labour Conventions which the Government of Cyprus has ratified"⁴⁸.

b) Collective bargaining

In Cyprus collective agreements traditionally play a primary role in the regulation of industrial relations with legislation playing a secondary role. Collective bargaining continues to be the foundation of the Cypriot labour relations systems and tripartite co-operation is the cornerstone of formulating and implementing labour and social policies.

It has to be distinguished that the "regulatory" part of collective agreements – namely: the terms regulating pay and working conditions issues, along with other issues arising from the

⁴⁷ http://www.mlsi.gov.cy/mlsi/dlr/dlr.nsf/dmlpartners_en/dmlpartners_en?OpenDocument

⁴⁸ http://www.mlsi.gov.cy/mlsi/dlr/dlr.nsf/dmlcode_en/dmlcode_en?OpenDocument

provision of labour – is not directly applicable to workers. In addition it is regular practice to refer to collective agreements as simple “gentlemen’s agreements”. In this context such agreements do not create rights and obligations in the public legal sphere since the terms of collective agreements are incorporated in individual contracts.⁴⁹

Collective bargaining mechanisms and procedures are decentralised – there are no national general collective labour agreements and the two fundamental bargaining levels are the sectoral and the enterprise levels. *“The usual term of the agreements (subject to bargaining) is two years, and in a number of cases three years. According to data from the Industrial Relations Division of the Ministry of Labour, in 2003 there were 13 sectoral collective agreements – in leather goods, clothing, footwear, metal products, construction, construction companies, electrical installations, transports, hotels, catering, oil companies and the financial sector – covering 26.7% of all employed earners (2001 figure). There were also around 450 enterprise-level collective agreements. Most of the abovementioned agreements were signed in 2001 and expired in December 2003”*⁵⁰.

Traditionally, terms and conditions of employment have been based, to a large extent, on the collective agreements concluded either at the sectoral or the enterprise level. The requirement of harmonising Cypriot legislation with the EU acquis has made the government ensure that a number of terms and conditions of employment would be guaranteed by national law and officially imposed. It should be stressed that these steps have not affected the significance and importance of collective agreements, but “have supported providing for minimum terms and conditions of employment for non-unionised employees, but also for employees in enterprises that do not have signed collective agreements. It should be noted that in the case that specific provisions of collective agreements provide for less favourable terms than those provided for by the new labour laws, these provisions were amended to reach the legislative minimums”⁵¹. It has to be noted that the Cypriot trade unions feel that their bargaining position has been weakened due to globalisation, Cyprus’ accession to the EU and market liberalisation.

c) National and sectoral level collective bargaining

At national level collective bargaining is restricted to the constraints of sectoral level bargaining because of Cyprus’ small geographical size. And consequently, a national level

⁴⁹ European Foundation on the Improvement of Living and Working Conditions, *Social dialogue and EMU in Cyprus, Czech Republic, Latvia, Lithuania and Slovakia* – workshop; Vienna, 26-28 May 2003, Discussion paper – abstract. <http://www.eiro.eurofound.eu.int/2004/01/feature/cy0401102f.html>

⁵⁰ European Foundation on the Improvement of Living and Working Conditions, *2003 Annual Review for Cyprus*, <http://www.eiro.eurofound.eu.int/2004/01/feature/cy0401102f.html>

⁵¹ http://www.mlsi.gov.cy/mlsi/dlr/dlr.nsf/dmlsystem_en/dmlsystem_en?OpenDocument

collective agreement is also a sectoral agreement and vice versa - due to the small size of the Island - sectoral agreements are also national (since they have pan-Cyprian coverage).

According to data provided by EIRO's Report in 2004 there were 13 national/sectoral collective agreements in the private sector. They covered about 26.7% of the total number of employees in Cyprus (2001) and about 41.4% of all trade union members.

Table 1: National/sectoral collective agreements and number of employees involved

SECTOR	No. of employees
Leather products	200
Clothing	5000
Footwear	800
Wood products	2500
Metal products	4000
Construction	23000
Construction companies	500
Electrical equip. installation	1500
Vehicle importers	600
Hotels	15000
Catering establishments	11000
Petrol companies	200
Banking sector	9200
TOTAL	73500

(Source: *Social dialogue and conflict resolution in Cyprus*, European foundation for the Improvement of Living and Working Conditions, 2004, <http://www.eurofound.eu.int/publications/files/EF0446EN.pdf>)

Most agreements have a two-year duration (some are signed for three years). As a result of their extensive and broad coverage, direct negotiations are usually long, complex and complicated. As a general rule, collective agreements, except for the wide spectrum of working terms and conditions, regulate other issues related to the functioning of the company. This complexity and extensiveness very often leads to additional disputes over their interpretation.

During the negotiations, both employers' and employees' representatives usually agree to use, if the need arises, the services offered by the mediation service at the Ministry of Labour.

d) Company – level collective bargaining

It was estimated that in 2004 over 450 company-level collective agreements were in force. They were most popular in the manufacturing sector. They were also common in the service sector. In agriculture, because of the predominance of self-employment among farmers, such agreements are quite rare. Collective agreements at company-level are more often resolved at the direct negotiating stage given that employers prefer to resolve issues as quickly as possible instead of engaging in lengthy procedures. Furthermore, trade union representatives

in private companies usually have closer and more harmonious relations with the employer, making the settlement of issues much simpler⁵².

e) Social dialogue in the Northern part of the island

The tripartite system also functions in the northern part of the island, however it is carried out in a different administrative and legal framework. Collective agreements are also “gentlemen’s agreements” as in the southern part of the island. Each enterprise has its own collective agreement signed with its strongest trade union; but sometimes the government administration selects the trade union with which it signs the collective agreement leaving another trade union aside. As a result trade unions also have a political role – they are in opposition to the administration and are always in favour of any actions that may result in reuniting the island. At present the following issues are discussed: making the social security system more coherent – the Turk-SEN trade union has submitted a proposal for solutions to the administration – and initiating a work provident fund. The level of unionisation is not as high as in Southern Cyprus as there is a higher level of unemployment and the workers are afraid of getting involved in the trade union movement as they fear it could result in job loss. Trade unions are in favour of introducing recruitment via employment agencies which would enable to monitor the inflow of migrant workers. For them it is also important to introduce a civil servant structure. Cooperation between trade unions from the Greek and the Turkish parts of the island exists, i.e. they have the same position concerning fixed-term contracts, where for instance they jointly negotiate, sign collective agreements and take industrial actions when possible.

f) “Hot” issues on the social agenda

There are a couple of issues that can be regarded as “hot” and that preoccupy minds of the Cypriot social partners. These issues are important for any types of changes taking place at company level. They are the following:

⁵² *Social dialogue and conflict resolution in Cyprus*, European foundation for the Improvement of Living and Working Conditions, 2004, <http://www.eurofound.eu.int/publications/files/EF0446EN.pdf>

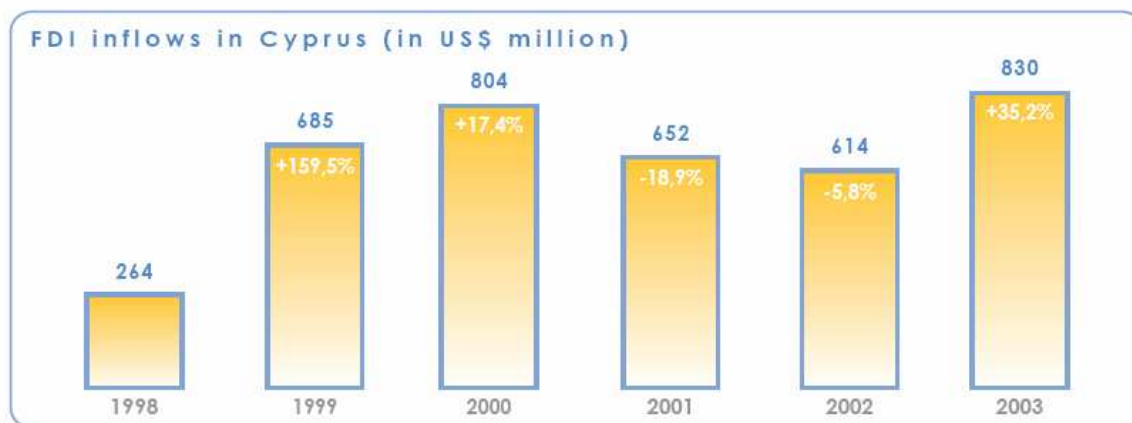
<i>Issue</i>	<i>Employers</i>	<i>Trade Unions</i>
<i>Wage formation system</i>	<ul style="list-style-type: none"> - wages/salaries should be linked to productivity and less rigid - COLA should be reformed - minimum wage should be abolished 	<ul style="list-style-type: none"> - keep as it is - COLA should be maintained - minimum wage should be secured - do not accept freeze on wages/salaries
<i>New methods of work organisation</i>	<ul style="list-style-type: none"> - introducing a variety of new work organisation methods 	<ul style="list-style-type: none"> - for part-time work - against fixed-term contracts
<i>Work permits for foreign workers</i>	<ul style="list-style-type: none"> - should be obtained by employer - more liberal immigration policy 	<ul style="list-style-type: none"> - should be obtained by employee - immigration policy should be kept as it is
<i>Collective bargaining</i>	<ul style="list-style-type: none"> - keep as it is ("gents agreement") - more individual contracts 	<ul style="list-style-type: none"> - should be reformed and legally binding - not very keen on individual contracts
<i>Productivity</i>	<ul style="list-style-type: none"> - should be increased in order to make the Cypriot economy competitiveness 	<ul style="list-style-type: none"> - should be discussed together with COLA
<i>Professional training</i>	<ul style="list-style-type: none"> - 50% working time + 50% employee free time 	<ul style="list-style-type: none"> - 100% working time
<i>Economic – Social Committee</i>	<ul style="list-style-type: none"> - against establishing 	<ul style="list-style-type: none"> - for establishing

Main questions to be resolved are the following:

- How to limit Cyprus' dependence on tourism?
- How to overcome the productivity/cost of living dilemma?
- Immigrant workforce: how to anticipate inflow? What measures should be introduced?
- What is the role of social partners in resolving the above issues?

Annex 1

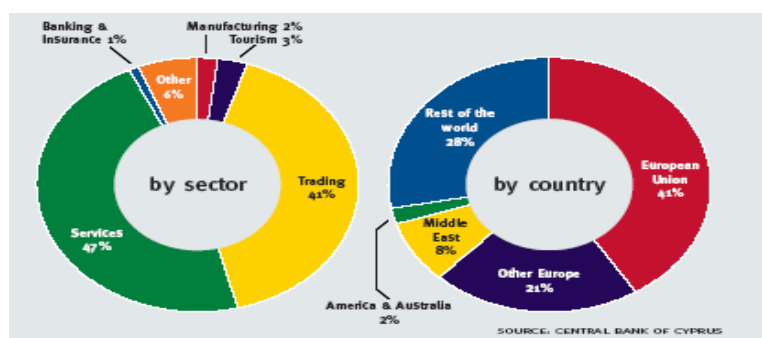
Graph 1.



Source: UNCTAD, World Investment Report 2004

Source: *Investing in Cyprus: A guide for foreign investors*, The Foreign Investors Service Centre, Ministry of Commerce, Industry and Tourism of the Republic of Cyprus, 2004

Graph 2.



Source: *CEO Guide to Direct Investment in the New Europe: Cyprus*, International Direct Investment Group, <http://www.corporatelocation.com/pdf/countries/05cyprus.pdf>

Graph 3.



Source: *Report on Structural Reforms in Cyprus in the Context of the Cardiff Exercise – October 2004*, [http://www.mof.gov.cy/mof/mof.nsf/1CAE9DF73E4A2C5DC2256F8C002C833E/\\$FILE/CARDIFF%20REPORT%202004FINAL.do](http://www.mof.gov.cy/mof/mof.nsf/1CAE9DF73E4A2C5DC2256F8C002C833E/$FILE/CARDIFF%20REPORT%202004FINAL.do)

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Table 1. Employment performance indicators

Performance Indicators	Cyprus			EU - 15	European target	Strategic target 2006
	2001	2002	2003	2003		
Overall Employment rate (15 – 64)	67,9	68,5	69,2	64,4	70 in 2010 Lisbon target	70.0+
Employment rate of older workers (55 – 64)	49,1	49,2	50,2	41,7	50 in 2010 Stockholm target	52,0
Employment rate of women (15-64)	57,1	59,0	60,2	56,0	60 in 2010 Lisbon target	62,0
Unemployment rate	4,0	3,3	4,1	8,1	2,8 average rate of the 3 most advanced Member States	3,5
Long-term unemployment rate	0,9	0,7	1,0	3,3	0,9 average rate of the 3 most advanced Member States	0,9
Youth Unemployment rate	8,2	7,7	8,9	15,9	5,6 average rate of the 3 most advanced Member States	7,5
Unemployment rate of women	5,7	4,2	4,6	8,9	3,3 average rate of the 3 most advanced Member States	4,0

Source: *National Action Plan for Employment 2004-2006*, Republic of Cyprus, Ministry of Labour and Social Insurance, July 2003,
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Table 2. Employment and labour force by level of education, Cyprus 2003

	Educational attainment			
	Total	Low	Medium	High
Working age population	473,000	175,010	174,537	124,399
Employment	327,300	90,700	128,100	109,200
Labour force	341,500	95,600	133,300	113,600
Unemployed	14,190	4,900	5,200	4,400
Unemployment rate (% of labour force)	4.2%	5.1%	3.9%	3.8%
Employment rate (% of working age population)	69.2%	51.8%	73.4%	87.8%
Activity rate (labour force as a % of working age population)	72.2%	54.6%	76.4%	91.3%

Source: *Thematic feature – unskilled workers*, <http://www.eiro.eurofound.eu.int/2005/02/tfeature/cy0502103t.html>

Annex 2

Interviewed persons

Name	Organization and affiliation
Mr Michael ANTONIOU	OEB (UNICE)
Mr Dimitris KITTENIS	SEK (ETUC)
Mr Elmas NIHAD	Turk-SEN (ETUC)
Mr Emilios MICHAEL	Chamber of Commerce (UEAPME)

Annex 3

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