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Assessment of the 2013 national reform programme for CYPRUS

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EXECUTIVE SUMMARY

Economic Outlook

Economic activity in Cyprus significantly weakened in 2012, with real GDP decreasing by 2.4% on the back of the banking sector restructuring, fiscal consolidation and economic uncertainty. According to the Commission's spring 2013 forecast, GDP is expected to shrink by 8.7% this year and further projected declines in domestic demand and in investment point to a prolonged recession well into 2014. Labour market conditions worsened in 2012, with the unemployment rate reaching a record high of 11.9%, which is expected to deteriorate further to 15.5% in 2013 and to 16.9% in 2014, reflecting the contraction of economic activity. In addition, the temporary imposition of capital controls and withdrawal restrictions are expected to hamper international capital flows and to reduce business volumes in both domestically and internationally oriented companies. The bail-in of a large part of uninsured deposits implies a loss of wealth, which will also affect confidence, private consumption and investment.

Despite the sizeable consolidation measures undertaken, the headline budget deficit reached 6.3% of GDP in 2012 due to lower tax revenues and higher interest payments and social benefits. Cyprus has so far taken effective action to correct its deficit, making an average fiscal effort in 2011-12 of 2.4% of GDP (above the recommended 1.5%). Including the government's participation in the recapitalisation of the Cyprus Popular Bank, government debt in 2012 reached 85.8% of GDP, rising noticeably from 2011 (71.1% of GDP). This is expected to rise further to unprecedented levels for Cyprus.

Key Issues

The key objective of the Programme is to help Cyprus's return to a sustainable growth path with better employment prospects and to guarantee financial stability. The programme builds on the 2012 country-specific recommendations for Cyprus, which have been partly implemented to date, making the steadfast implementation of the programme essential for durable growth in the long-run. Full implementation of the programme will also be key to ensure progress towards all Europe 2020 targets.

Cyprus has already made important progress in the implementation of the policies laid down in the programme, particularly when it comes to fiscal consolidation and downsizing the banking sector. The authorities adopted sizeable measures prior to signing the programme, while policies set as prior actions have been met. The necessary downsizing and restructuring of the banking sector is under way, which has already reduced the size of the banking sector from 550% of GDP to 350%.

Key challenges and risks in the period ahead relate to developments in domestic credit conditions and the reorganisation of the financial sector, with possible spillovers onto

related professional and financial services, as well as rapidly deteriorating labour market conditions. Upside risks relate to potential investment activity in the energy sector. More generally, the transition to a more diversified growth model will be challenging for the economy in the coming years. Proper implementation of EU funds, as well as increasing job opportunities for young people and preserving their employability prospects will contribute to laying the foundations for sustainable long-term growth for Cyprus.

- **Banking sector**: Further downsizing is to be achieved through the restructuring of the cooperative credit institutions, where regulation and supervision should be aligned to that of the commercial banks. Strengthening of the anti-money laundering (AML) framework in Cyprus to enhance financial transparency is underway, but further progress is needed, particularly with regard to the identification of the ultimate beneficial owners of Cypriot legal persons and the reporting of suspicious transactions.

- **Public finances**: A fiscal adjustment is currently underway, aiming to improve the primary balance by more than 4% of GDP in 2013-2016. In order to achieve annual primary balance targets (of -2.4% of GDP in 2013, -4.3% of GDP in 2014, -2.1% of GDP in 2015 and +1.2% of GDP in 2016), Cyprus will need to reduce the public sector wage bill and social benefits, while minimising the effects on disadvantaged people. The government has taken steps to strengthen fiscal management and expenditure control through the introduction of a medium-term budgetary framework law, which should be implemented

- **Structural reform**: Structural reforms to ensure the long-term sustainability of public finances and support competitiveness and balanced growth include a comprehensive pension review, measures towards a healthcare reform, a comprehensive reform to improve the effectiveness and the efficiency of tax collection and administration, public service restructuring and revision of the social welfare system. Improvements are also planned to make it easier to compete in the service markets, reduce the numbers of regulated professions, reinvigorate tourism and revive the housing market. In the energy sector, a plan for the infrastructure required to exploit natural gas reserves is being developed.

1. INTRODUCTION

Following the request from Cyprus on 25 June 2012, a comprehensive Economic Adjustment Programme was agreed with the European Commission, the European Central Bank, the International Monetary Fund and the Cypriot authorities on 2 April 2013. The policy Programme covers the period from the second semester of 2013 until the first semester of 2016. The Programme was agreed by the euro area Member States on 24 April 2013 and by the IMF Board on 15 May 2013. It will be financed through contributions from the ESM (EUR 9 billion) and the IMF (EUR 1 billion). The ESM first disbursement of EUR 2 billion took place on 13 May 2013.

The main objectives of the policy Programme build on three main pillars**:** i) policies to restore the soundness of the financial sector and rebuild the confidence of depositors and markets, based on restructuring and downsizing of the financial institutions, strengthening their supervision, and addressing capital and liquidity shortfalls; ii) measures to achieve a primary balance of 4% of GDP in 2018 and maintain that level thereafter, and to correct the excessive general government deficit as soon as possible; and iii) structural reforms to support competitiveness and enable the economy to return to sustainable growth, allowing for the unwinding of macroeconomic imbalances.

The Commission, the ECB and the IMF monitor the implementation of the Programme on a quarterly basis. Compliance with the terms set out in the Memorandum of Understanding (MoU) and in the IMF's Memorandum of Economic and Financial Policies is assessed prior to every quarterly loan disbursement. Given the conditionality attached to the programme under the MoU and the regular reporting and monitoring requirements, programme countries have been exempted from the obligation to submit national reform programmes (NRP) and stability or convergence programmes (SCP)[1]. Cyprus nonetheless announced the submission of an updated NRP on a voluntary basis, which however was not yet received at the time of the finalisation of this report.[2] Therefore, the assessment in this Staff Working Document under the 2013 European Semester is based on data available to the Commission. It provides a synthesis of recent progress in implementing the programme and of progress towards Europe 2020 targets. It also reports on progress made in implementing the 2012 country-specific recommendations prior to the agreement on the Programme. Additional details can be found in the European Commission's quarterly reviews of economic adjustment programme implementation.

2. ECONOMIC SITUATION AND OUTLOOK

Economic activity in Cyprus weakened significantly with real GDP decelerating by 2.4% in 2012. The contraction was driven by a marked decline in domestic consumption and investment activity, which in turn suffered as a result of the tightening credit conditions (at the back of the on-going process of the banking sector's deleveraging and the high-level of corporate indebtedness), fiscal consolidation, significant deterioration in the labour market,

[1] See the Secretariat General's letter to ambassadors of 13 September 2012 (Ares(2012)1063684).
[2] The Cypriot Council of Ministers was yet to approve the NRP.

and anaemic consumer confidence (the lowest in the EU). The external sector made a positive contribution due to good export performance (tourism being the main driver) and a strong contraction of import volumes, primarily of goods.

In 2013, real GDP is expected to decline sharply by 8.7%. This sharp decline is affected in particular by the immediate restructuring of the banking sector, which influences net credit growth, fiscal consolidation, and the high degree of economic uncertainty which in turn weigh on domestic demand and investment. In addition, the temporary imposition of capital controls and withdrawal restrictions is expected to hamper international capital flows and to reduce business volumes in both domestically and internationally oriented companies. The bail-in of a large part of uninsured deposits implies a loss of wealth, which will also affect confidence, private consumption and investment. The profound contraction in economic activity is expected to weigh significantly on employment. The employment rate has been on a declining path since 2009 decreasing to 70.2 in 2012 with a further significant decline expected in 2013 and 2014 of around 10 pps. At the same time, unemployment has been rising to unprecedented levels reaching a historically high of 11.9% in 2012. Unemployment is expected to increase further to reach 16.9% in 2014. Youth unemployment has also been on a steep increasing path displaying one of the highest year-on-year increases in the EU in 2011 and 2012 and reaching 27.8% in 2012. The rapid rise of youth unemployment is accompanied by a significant growth of young people under 25 who are neither in employment nor in education or training (NEETs) over the last few years (reaching 16% in 2012). Long-term unemployment in percentage of total unemployment has risen sharply standing at 30.1% in 2012. Reduced business activity, the restructuring of the financial sector (with possible spill overs to professional business services), the decline in domestic demand and investment activity, the hiring freeze in the public sector, and skills mismatches are expected to push the unemployment rate up to 15.5% in 2013 and 16.9% in 2014.

Despite the substantial consolidation measures undertaken, the general government deficit reached 6.3% of GDP in 2012. Tax revenues decreased as a result of lower revenues from both direct and indirect taxes. Corporate profits fell and social contributions decreased in line with the deterioration in labour market conditions. Indirect tax revenue was affected by weak household consumption. Overall, expenditure increased slightly. While primary expenditure was reduced significantly, interest payments increased because of borrowing difficulties leading to higher interest rates and to higher debt. Wages and salaries were reduced, but social benefits increased due to rising unemployment and a wave of early retirements. Investment expenditure decreased significantly.

Debt developments were driven by the higher-than-expected deficits outcomes, lower-than-expected growth, and increased borrowing costs to cover Cyprus's financing needs. Together with the government's participation in the recapitalisation of the Cyprus Popular Bank, debt in 2012 reached 85.8% of GDP, a marked increase in relation to 2011 (71.1% of GDP). The debt-to-GDP ratio is expected to rise to unprecedented levels for Cyprus. It is anticipated that public debt developments will be largely influenced by the general government deficit, the recapitalisation of some financial institutions, notably the cooperative credit institutions and the contraction of GDP.

Macroeconomic risks remain important and tilted to the downside. On the domestic front, downside risks are associated with domestic credit conditions and further deterioration of confidence in the banking system. Moreover, there is a non-negligible risk of a cycle of household and corporate defaults propagating through the economy, leading to further banking sector losses, worsening of labour market conditions, a stronger than expected fall in house price and a prolonged loss of business and consumer confidence. Moreover, the deep restructuring of the Cypriot banking sector could have significant spillovers on related professional business services and financial services exports. More generally, the transition to a more diversified growth model will be challenging for the economy in the coming years and will imply a re-allocation of economic resources across sectors, which may take time and will require flexible factor and product markets. Upside risks for the Cypriot economy are limited, relating mainly to higher investment activity in the energy sector (the import of natural gas by 2015 as an interim solution to the use of Cyprus's own off-shore gas reserves later in the decade), and possible improvements in the external outlook should euro area economic activity prove to be stronger than expected.

3. ECONOMIC CHALLENGES

The key objective of the Programme is to help Cyprus's return to a sustainable growth path with better employment prospects and to guarantee financial stability. While addressing the financial, fiscal, and structural challenges facing Cyprus, the programme follows a balanced approach to mitigate adverse social effects, encompassing the protection of disadvantaged people. The Programme was officially signed on 26 April 2013, but the Cypriot authorities had since November 2012 taken action in line with the policy advice provided in the provisional staff-level agreement of November 2012 and the Eurogroup's decisions on 25 March 2013.

3.1 Fiscal policy and taxation

A fiscal adjustment is being pursued aimed at improving the primary balance by more than 4% of GDP over the programme period 2013-2016. After significant consolidation measures of about 4% of GDP in 2012 undertaken by Cyprus before requesting financial assistance, additional measures of about 5% of GDP were adopted in December 2012. In addition, following the Eurogroup of 25 March 2013, further permanent revenue consolidation measures of about 1½% GDP were adopted, enforceable also in 2013. Fiscal consolidation measures of around 1¾% of GDP in 2014 were already legislated and adopted in December 2012. Over the medium term, fiscal consolidation should be maintained by containing expenditure growth, improving the structure of taxation and undertaking fiscal-structural measures.

Cyprus' total tax to GDP ratio has dropped from about 40% in 2007 to about 35% in 2011. Due to the high share of consumption in the economy, Cyprus derived close to 42% of its revenues in 2011 from indirect taxes, of which VAT accounted for almost 60%. Indirect taxes collection represented 14.7% of GDP, the 6th highest level in the EU. Interestingly, at 6.8% GDP, corporate taxes collected were the highest in the EU, while personal income taxes and social security contributions, respectively at 4.2 and 8.7% GDP were below EU average. At 2.9% GDP, environmental taxes were the 6th highest in the EU but property taxes were at 0.8% GDP relatively low.

Annual budgetary targets for 2013-2016, set as required primary balance targets, were established in the MoU (primary balance targets: -2.4% of GDP in 2013; -4.3% of GDP in 2014, -2.1% of GDP in 2015, and 1.2% of GDP in 2016), while the headline deficit is expected to decline gradually to below 3% of GDP in 2016. In order to achieve these annual budgetary targets, measures were adopted to reduce the growth in expenditure on the public sector wage bill (i.e. progressive scale of wage cuts in 2013 and 2014, extension of freeze in increments, reduction in the number of public sector employees, and extension of the suspension of wage indexation system) and social benefits (through a combination of abolishing/streamlining certain schemes and introducing/tightening means-testing criteria) while minimising the social impact of consolidation towards disadvantaged people. A range of savings on other current expenditure (such as transfers to state-owned enterprises and semi-public institutions, and reductions in budgetary appropriations for semi-governmental organisations) were also adopted. Tax increases, both indirect (standard and reduced VAT, excise duties on alcohol, tobacco and petrol) and direct (withholding tax on interest, corporate income tax, and bank levy) as well as increases in property taxation were also approved by the Cypriot Parliament. Reforms relating to the pension system, affecting both the public employees' pension system and the general pension system were also agreed and are expected to have a fiscal benefit over the long run.

In view of the distance from the 3% of GDP reference value of the deficit at the end of 2012 and despite the fact that Cyprus had delivered effective action in order to meet the Excessive Deficit Procedure (EDP) requirements, on 16 May 2013 the Council granted an extension of the EDP deadline and adopted a revised Recommendation under Article 126.7 recommending Cyprus to put an end to the present excessive budget deficit situation by 2016. Cyprus was considered to have taken effective action in 2011-2012, based on an average fiscal effort of 2.4% of GDP, after correction for the downward revision of the potential output and for unexpected revenue shortfalls, which is above the fiscal effort of at least 1½ of GDP over 2011-2012 recommended by the Council.

The government has taken steps to strengthen fiscal management and expenditure control, one of the key fiscal-structural reforms in the MoU. The *Law on Regulation of the Medium-Term Budgetary Framework and Fiscal Rules (MTBF Law)* was adopted with the 2013 Budget Law. This law institutionalises the MTBF process which remains to be implemented. A forecast for medium-term expenditure targets with overall composition of expenditure adjustment and expenditure projections by line ministry through 2015 was also presented. The medium-term budgetary targets are in line with the Programme's primary deficit ceilings and the goal of reaching a primary deficit of 1.2% by 2016. The authorities are currently focusing on secondary regulations to ensure the implementation of the MTBF and the establishment of a fiscal council, to be adopted by Q2-2013.

3.2 Financial Sector

Until recently, the domestic banking sector, including the cooperative credit institutions, represented 550% of GDP. The necessary downsizing and restructuring of the banking sector is under way. The House of Representatives adopted legislation on 22 March 2013 establishing a comprehensive framework for the recovery and resolution of credit institutions, drawn, *inter alia*, on the relevant proposal of the European Commission[3] (EC). Under the

[3] http://ec.europa.eu/internal_market/bank/crisis_management/index_en.htm#framework2012

terms of that legislation, the Central Bank of Cyprus (CBC) is the single resolution authority for banks and cooperative credit institutions alike. On the basis of this new framework, the Cypriot authorities have proceeded with (i) the carve-out of the Greek operations of the two largest Cypriot banks; (ii) the resolution of Cyprus Popular Bank and the absorption of selected assets and liabilities by the Bank of Cyprus; and (iii) the recapitalisation of the Bank of Cyprus through a debt to equity conversion, without recourse to tax-payer money. As a result of these measures, the Cypriot banking sector was downsized immediately and significantly to 350% of GDP and the Bank of Cyprus has been fully recapitalised in order to regain its eligible counterparty status for the purpose of its participation in regular Eurosystem monetary policy operations. Further downsizing is to be achieved through the restructuring of the cooperative credit institutions.

To prevent massive liquidity outflows in the Cypriot banking sector, administrative measures had to be imposed. After the announcement of the resolution and the restructuring of the two largest banks on 16 March 2013, bank holidays were declared until the banks reopened on 28 March 2013. On the bank holidays and during weekends, all payments and transfers within a banking group as well as inter-bank transactions were prohibited, with a few exemptions related to essential payments. In addition, limits on cash withdrawals were imposed for the two banks under stress. When the banks reopened, a strict regime was put in place in order to avoid excessive liquidity outflows. The overall objective was to allow current transactions for goods and services within and outside the country, but to limit capital transactions. The regime was applied to all banks including foreign banks, and was initially implemented for seven days, although it has already been prolonged and eased on some points. With a view to causing the least damage to economic activity and finding ways to end the restrictions, a monitoring committee makes sure that the measures taken are proportional to the problems to be tackled.

Prior to the dramatic worsening of the banking sector in early 2013, Cypriot banks had faced significant capital losses arising from their large sovereign and loan exposure to Greece as well as the weak performance of the domestic economy. An independent consulting firm carried out a due diligence exercise to define the total capital needs of banks and cooperative credit societies. This was finalised at the end of January 2013. The bank-by-bank stress test resulted in an overall capital shortfall of EUR 6 billion under a baseline scenario with a Core Tier 1 target ration of 9% and of EUR 8.9 billion under the adverse macroeconomic scenario with a Core Tier 1 target ratio of 6%. In response to these results, the two main banks were subject to intervention and were restructured using the recently adopted resolution law, entitled *Resolution of Credit and Other Institutions Law of 2013*, which endows the Central Bank with new powers, as a Resolution Authority, to implement restructuring measures where banks are either no longer viable or are likely to no longer be viable[4]. The Bank of Cyprus was recapitalised to a Core Tier 1 ratio of 9% under the adverse macroeconomic scenario. The Central Bank of Cyprus committed to increase the minimum Core Tier 1 capital ratio from the present level of 8% to 9% by December 2013.

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[4] These measures include a forced capital increase, transfer of assets and liabilities to a bridge bank or asset management company and, as subsequently utilised in relation to the Bank of Cyprus and the Cyprus Popular Bank, the sale of operations and bail-in.

In addressing the significant weakness in the regulation of cooperative credit institutions, the authorities have committed to aligning the regulation and supervision of the cooperative credit institutions with that of the commercial banks. The supervision of the cooperative credit institutions is to be dispatched from the Ministry of Commerce, Industry and Tourism and is be integrated into the Central Bank of Cyprus by the end of July 2013 pursuant to legislation to be adopted by the end of June 2013.

Strengthening of the anti-money laundering (AML) framework in Cyprus to enhance financial transparency is underway, but further progress is needed. An independent audit was finalised at the end of April 2013. As part of a comprehensive action plan, identification of the ultimate beneficial owners of Cypriot legal persons and arrangements and reporting of suspicious transactions should be improved. The Cypriot authorities intend to establish trust registers with the supervisory authorities and launch a third-party assessment of the functioning of the Registrar of companies. Also, the supervision department of the CBC will review its off-site and on-site supervisory procedures with a view to further implementing a risk-based approach to anti-money laundering supervision procedures.

3.3 Labour market policy, education and social policy

The continuing decline of the employment rate since 2009 along, with the projected steep further reduction over the next two years, is expected to widen considerably the gap in relation to the national target rendering its attainment extremely challenging. Ambitious and well-focused policy efforts, in particular as regards the labour market participation of women, young and the elderly will be critical in reversing this negative trend and curbing the rising unemployment. In addition to the swift implementation of the current measures to achieve the national early school leaving target, Cyprus could take actions to provide better guidance to youngsters on career opportunities, to promote the attractiveness and relevance of VET, reform curricula allowing for more work-based learning opportunities at secondary and higher education levels as well as to reinforce the link between educational outcomes and skills forecasting.

In a context of increasing unemployment and greater strain on the social protection budget, the population at risk of poverty or exclusion has increased and certain categories of the population, such as the elderly, still face severe problems. Since the outset of the crisis, some indicators have deteriorated or remained at high levels. This is especially true of poverty among the elderly. Cyprus still faces a serious problem, as the risk of poverty or social exclusion for elderly, despite improvements in 2011, remains very high. The measures introduced in 2008 and 2009 are still in force and are in the right direction. However, the problem still needs to be addressed. So far, poverty indicators have not shown dramatic negative impacts, but the real situation could be distorted given the fact that the most recent poverty indicators reflect a time lag of two years.

Structural reforms to ensure the long-term sustainability of public finances and to support competitiveness and underpin a sustainable and balanced growth are included in the MoU, which builds on the Council Recommendations addressed to Cyprus under the European Semester in 2012. A comprehensive pension reform encompassing both the Government Employees Pension System (GEPS) and the General Social Insurance System (GSIS) is expected to have a significant budgetary effect in the longer term. In January 2013, the statutory retirement age was increased by two years for the GEPS, while the minimum age for entitlement to an unreduced pension is being raised by six month per year in the GSIS to bring it into line with the statutory retirement age. Automatic adjustments for changes in life-expectancy will take place every five years from 2018 onwards and early retirement penalties of 0.5% per month are imposed under both systems. In addition, under the GEPS, all pension benefits are now indexed to prices rather than wages, while pension benefits are being calculated on a pro-rata basis taking into account life-time service. Lump-sum payments accruing from 1 January 2013 onwards under the GEPS will now be taxed as personal income with public sector employees having the option to turn the lump sum into an annuity. Pensions under both systems are frozen for the programme period. An actuarial study for the GSIS will be carried out by the end of July 2013 to provide additional reform options to ensure the long-term viability of the national pension system. The actuarial study will project the scheme's finances on a cash basis. The study will analyse the impact of additional reform options such as benefit reductions (while considering adequacy), an increase in the statutory retirement age and increases in contribution rates or combinations thereof taking into account the impact on labour costs. If needed, a comprehensive reform with the aim of establishing the long-term viability of the pension system will be carried out. This reform will be adopted by the end of December 2013 and enter into force on 1 January 2014.

Cyprus is progressively taking steps to strengthen the sustainability of the funding structure and the efficiency of public healthcare provisions, especially as the economic crisis is expected to increase the demand on public provision of health care services. Measures have been taken to simplify exemptions for access to free public health care, based on income and disease-related criteria only. As a consequence, a compulsory health care contribution for public servants and public servant pensioners of 1.5% of gross salaries and pensions was adopted. As a step towards universal healthcare coverage, an actuarial study will assess the potential fiscal risks and benefits of the planned introduction of the National Health System in 2015. Financial disincentives were put into place to minimise the use of unnecessary medical services and goods and to steer patients towards the right levels of medical care. Fees for the use of medical services by non-beneficiaries were increased by 30% in order to reflect the associated costs of service. Several additional reform measures target efficiency increases: A ministerial decision now paves the way for a much needed restructuring plan for public hospitals, improving quality and optimising costs; the basket of publicly reimbursable medical services and goods is being reassessed based on objective criteria, including cost-effectiveness; clinical protocols for laboratory test and pharmaceuticals are being elaborated; and working time arrangements of healthcare staff are being modified to increase accessibility to public healthcare services.

As part of the fiscal consolidation measures currently pursued, the authorities reduced expenditure allocated to untargeted social benefits by abolishing various schemes (e.g. mother's allowance, special grant to pensioners, dietary allowance), streamlining some housing schemes administered by the Ministry of the Interior, and reducing allowances (e.g. child benefit, maternity allowance). After its review, a reform of the welfare system is anticipated to be implemented by January 2014 as well as the transfer of all competencies and responsibilities related to the administration and provision of all social benefits (currently administered by different public authorities) to the Ministry of Labour and Social Security.

3.4 Structural Reforms promoting growth and competitiveness

To improve competitiveness, the government has taken steps to reform the wage indexation mechanism (COLA) by reducing the frequency of its adjustment (once instead of twice a year), introducing a mechanism for automatic suspension during adverse economic conditions and moving from full to partial indexation of 50% of past inflation. The application of COLA is suspended in the public sector for the full Programme period while the new system is expected to be extended to the private sector too by means of a tripartite agreement.

A number of other structural reforms in goods and services markets have been identified as policy action in the MoU to help the Cyprus economy restore its growth potential and improve competitiveness. The Cypriot authorities have committed to remove obstacles in services markets by easing the requirements related to entry and establishment, and by eliminating requirements concerning minimum tariffs, unless they are justified by overriding reasons of public interest and are proportionate. Full implementation of the Service Directive is anticipated by the first half of 2013. Concerning regulated professions, a comprehensive review will be carried out in order to eliminate those requirements that are not justified by overriding reasons of public interest and are not proportionate. Since tourism is one of Cyprus's largest sectors and an important potential driver of future growth and employment, a reinvigoration of its competitiveness is foreseen. To that end, a study on the improvement of the tourism sector business model will be pursued and the Tourism Strategy will be revisited. Regarding the housing market, the authorities have committed to reduce the backlog in the issuance and transfer of titles deeds, improve the pace of court handling and eliminate court backlog, and speed up the procedures on the forced sale of mortgaged property. With regard to the energy sector, Cyprus is called upon to complete the transposition and implementation of the Third Energy Package. The authorities have committed to formulate a comprehensive development plan for the rearrangement of its energy sector, including a roll-out plan for the infrastructure required for the exploitation of natural gas. The plan would also encompass an outline of the regulatory regime and market organisation for the energy sector and gas exports, as well as a plan to establish the institutional framework for the management of hydrocarbon recourses, including a resource fund, which should receive and manage public revenues from offshore gas exploitation and which is set up based on internationally-recognised best practice.

While Cyprus has achieved its interim 2011/2012 target on gross final energy consumption, attaining good progress will become more ambitious towards 2020. Special attention should be paid to the timely implementation of strong support measures, particularly in the transport and electricity sectors.

3.5 Modernising public administration

Cyprus is called to upon to make considerable improvements in the efficiency of the tax administration and to render tax collection more efficient under the Council Recommendations of the 2012 European Semester. In this respect, a comprehensive reform plan to improve the effectiveness and the efficiency of tax collection and administration is to be implemented from the budget year 2014 onwards. Among the key elements to this reform are the strengthening of powers by the tax authorities to ensure payment of outstanding tax obligations, the attribution of personal responsibility for fraudulent filing of company taxes, the establishment of clear objectives including on revenue collection results for each revenue administration entity, and the rationalisation of revenue administration. The Cypriot authorities also committed to removing the remaining barriers to timely and effective international tax cooperation. Following a technical assistance mission, which focused on a thorough review across all aspects of tax administration, a series of specific recommendations and a timetable for a comprehensive reform of the tax administration was set.

The public sector represents a large share of public expenditure in Cyprus. In order to generate savings in the short-term and to enhance the efficiency of the public sector in the longer term, the authorities have committed to removing impediments to staff mobility within the public and broader public sector and to gradually increase the working time in the public sector (legislation on this was passed in December 2012). In line with the MoU measures, the authorities have drawn up the terms of reference for a review of the public administration system, the eventual recommendations of which will be adopted and implemented by 2014.

4. PROGRESS ON EUROPE 2020 AND ASSESSMENT OF PROGRESS ON CSRS ISSUED IN 2012

Making progress towards achieving certain Europe 2020 targets and progressing further in others areas will be a challenge. The sharp economic contraction and the prolonged period of uncertainty particularly prior to the final agreement of the MoU affected Cyprus's progress in meeting its national targets. Some indicators have deteriorated while climate indicators seem to be ahead of interim milestones.

Committed to the policy advice outlined in the Programme, Cyprus has undertaken significant steps towards the implementation of the Country-Specific Recommendations issued in 2012. Sizeable fiscal consolidation is pursued with measures already legislated and adopted; the financial sectors reforms are on-going, while steps to gear progress in implementing structural reforms have been undertaken. To date the CSRs are considered to be partially implemented, making the steadfast implementation of the policy measures under the MoU essential for full compliance.

The Cypriot national commitments, along with the progress made on these commitments, along with an assessment of the CSRs issued in 2012, are summarised in the table below.

Europe 2020 (national targets and progress)	
2011 Commitments	**Summary assessment**
Employment rate: 75% - 77% of the population aged 20–64 should be employed by 2020.	Unemployment rate reached a record high of 11.9% in 2012 and expected to worsen further in subsequent years, reflecting the contraction of the economic activity. The employment rate has been on a declining path since 2009 decreasing to 70.2 in 2012 with a further significant decline expected in 2013 and 2014 of approximately 10 pps. Achieving the EU 2020 targets will require more ambitious and consistent policy efforts particularly as regards the labour market participation of women and youth.
R&D target: Increase R&D expenditure to 0.5% of GDP by 2020.	In 2011, R&D intensity decreased to 0.48% of GDP (the lowest in the EU27), compared to 0.5% in 2010. It is necessary to enhance the involvement of business in innovation and research activities and not to limit it on the

	public sector.
Greenhouse gas emissions target: Reduction of greenhouse gas emissions in non-ETS sectors by 5% (compared to 2005).	Change in non-ETS greenhouse gas emissions between 2005 and 2011: 8%. According to national projections submitted in 2011 (not updated in 2013) and taking existing measures into account, the target is expected to be reached: -19% in 2020, compared to 2005 (with a margin of 14 percentage points). Yet, challenges remain with respect to GHG linked to waste management, where Cyprus heads the list in municipal waste generation (80% of waste generated is landfilled), reliance on oil imports, energy intensity of the transport sector, and non-differentiated energy mix and low energy efficiency.
Renewable energy target: 13% of gross final energy consumption from renewable sources.	With a share of renewable energy in gross final energy consumption of 4.85% in 2010 (1.97% in transport), Cyprus has achieved its interim 2011/2012 target (4.8%). However, the targets will become more ambitious towards 2020 since Cyprus is not currently on track to achieve the 13% national EU target. Timely implementation of strong support measures, particularly in the transport and electricity sectors is warranted. Full transposition and notification of the Renewable Energy Directive should be pursued in due course. Transport represents more than half of the total CO_2 emissions from non-Emission Trading Scheme (non-ETS) activities in Cyprus and is about 75% more energy intensive than EU average. Therefore, reversing the rapidly increasing trend of CO_2 emissions from transport is key to enable Cyprus to meet its 2020 target. The share of renewable energy sources in consumption of transport fuels has not increased in the last two years and was at 2% in 2010. Given Cyprus's heavy dependency on oil and oil imports (effect on the current account balance), it is essential for Cyprus to tap the economic potential linked to the move towards a low carbon and energy efficient economy.
Indicative national energy efficiency target for 2020: 0.463Mtoe energy savings in 2020 (14.4% reduction in 2020 compared to a reference scenario). This implies reaching a 2020 level of 2.756 Mtoe primary energy consumption and 2.205 Mtoe final energy consumption.	Cyprus faces a very high energy intensity of the economy, in particular of the transport sector combined with low energy efficiency, also of buildings. This is exacerbated by the non-differentiated energy mix and full dependence on imported oil, the lack of interconnectivity, and the low penetration of public transport. Cyprus has set an indicative national energy efficiency target in accordance with Articles 3 and 24 of the Energy Efficiency Directive (2012/27/EU). It has also expressed it, as required, in terms of an absolute level of primary and final energy consumption in 2020 and has provided information on the basis on which data this has been calculated.
Early school leaving target: Reduce the rate of early school leavers to 10% by 2020.	Cyprus performs better than the EU average in the area of school leaving (11.4% compared to 12.8% in 2012). A significant decrease of 25% in the number of ESLs was observed between 2006 and 2011, reflecting an active policy in this field. Children of the migrant workforce, in particular boys with low socio-economic background, are at the highest risk of dropping out of school. Measures to help integrate migrants include initiatives to help teachers cope with this challenge and to improve the teaching of Greek to migrant children. Pursuing such efforts would be important in view of the expected increased proportion of migrant children. Measures to address ESL are complemented by

	the development of quality vocational education and training (VET). Cyprus is characterised by the lowest participation rate[5] in upper secondary vocational education and training in EU.
Tertiary education target: Increase participation in higher education to 46%.	Cyprus has one of the highest tertiary attainment rates in the EU, with 49.9% compared to the European average of 35.8% in 2012. Demand for higher education is high, with 82% of students completing upper secondary education. Cyprus has already outperformed its national quantitative target. The real challenge in higher education is linked to a mismatch between the labour market needs and the profile of graduates. Recent tertiary education graduates in Cyprus have one of the lowest employment rates[6] in the EU and the share of young graduates in mathematics, science and technology is one of the lowest in the EU[7]. Ways to increase the higher education relevance to labour market needs could include better guidance to youngsters on career opportunities and future-oriented jobs, reform curricula allowing for recognised traineeships into higher education curricula as well as measures to reinforce the link between HE educational outcomes and skills forecast.
Target for reducing the population at risk of poverty or social exclusion in number of persons: Reduce the number of people at risk of poverty or social inclusion by 27 000 persons or decrease to 19.3% of the population.	With increasing unemployment and greater strain on the social protection budget, the population at risk of poverty or exclusion has increased, particularly the elderly. The at-risk-of-poverty or social exclusion rate has increased from 23.5% in 2010 to 23.7% in 2011 (EU27 average from 23.6% to 24.2%). As a consequence, the number of people at-risk-of-poverty or social exclusion has increased to 199 000 in 2011 from 192 000 in 2010. The at-risk-of poverty (AROP) rate of unemployed persons aged 18 or over in Cyprus saw a marginal decrease from 38.3% to 38.0% between 2009 and 2010 and has further decreased in 2011 (35.8%). Concerning child poverty which was not considered to be a problem in Cyprus until 2009, the at-risk-of-poverty and exclusion (AROPE) increased in 2011 (from 20.4% to 22.1%). In terms of poverty among the elderly, Cyprus still faces a serious problem as both AROPE and AROP rates for those over 65 remain very high despite their 8 pps amelioration between 2009 and 2011. AROPE in 2011 is almost double of the EU average (40.6% compared to 20.5%) while AROP is also more than double of the EU average (37.2% compared to 15.9% in 2011). The AROP rate for women over 65 is also more than double the EU average (39.9% vs 18.1% in 2011).

2012 commitments	**Summary assessment**
Country specific recommendations (CSRs)	
CSR1: Take additional measures to achieve a lasting correction of the excessive deficit in 2012. Rigorously implement the budgetary strategy,	**Cyprus has partially implemented CSR1:** › The Cypriot authorities had adopted a series of packages of fiscal consolidation measures in 2011, embedded in the 2012 Budget Law. In addition, they adopted fiscal

[5] Less than 15% of pupils.

[6] Only 76.7% of higher education graduates having graduated in the previous three years were employed in 2011, compared to an EU average of 82.7% (*Source:* Eurostat).

[7] The profile of CY HE graduates is characterised by a high share of graduates in social science, business and law (49.0% compared to the EU average of 35.7% in 2011) and a low share in ‘health and welfare’ and MST (respectively 7.6% and 13.3% compared to an EU average of 15.1% and 21.9%). In 2011, the number of MST graduates among 20-29 year olds in CY is 5.1 per 1000 people, compared to an EU average of 14.4.

supported by sufficiently specified measures, for the year 2013 and beyond to ensure the achievement of the medium-term budgetary objective (MTO) by 2014 and compliance with the expenditure benchmark and ensure sufficient progress with the debt reduction benchmark. Accelerate the phasing-in of an enforceable multiannual budgetary framework with a binding statutory basis and corrective mechanism. Take measures to keep tight control over expenditure and implement programme and performance budgeting as soon as possible. Improve tax compliance and fight against tax evasion.	measures for 2012-14 outlined in the MoU with the 2013 Budget Law and the MTBF for 2013-2015.. However, a series of adverse economic developments resulted in a sizeable contraction of the economy. Based on the Commission's Spring Forecast 2013, the general government deficit for 2012 is projected at -6.3% of GDP. › *The Law on Regulation of the Medium-Term Budgetary Framework and Fiscal Rules* (MTBF Law) was adopted with the 2013 Budget Law. › The value of several indicators, such as the administrative costs of tax collection and the share of the shadow economy, indicate a need and scope to improve both tax compliance and the tax administration. The 2013 Budget Law included special provisions to pursue the effort to fight against fraud and tax evasion. It is now mandatory for non-tax-resident companies registered in Cyprus to submit annual tax returns. Trusts are required to keep accounting records in relation to dividends and interests earned. Existing procedures regarding the exchange of information have been clarified, thereby aligning the Cypriot double tax treaty framework with the OECD guidelines and ensuring effective exchanges of information. However, measures to encourage moves from informal/undeclared work and to render tax collection more efficient should be reinforced. Improving revenue collection systems will enhance the fiscal impact of the numerous tax measures introduced recently.
CSR2: Further harmonise the supervisory and the regulatory framework for the cooperative credit societies in line with the standards applied for the commercial banks. Strengthen regulatory provisions for the efficient recapitalisation of the financial institutions in order to limit exposure of the financial sector to external shocks.	**Cyprus has partially implemented CSR2:** › As per MoU, Cyprus committed to integrating the supervision of the cooperative credit institutions into the Central Bank of Cyprus and legislation will be passed to strengthen governance of these institutions (by June 2013 as per MoU). › As per MoU, Cyprus committed to increase the minimum Core Tier 1 capital ratio from the present 8% to 9%, with financial institutions to comply by the end of December 2013 (ii) undercapitalised institutions in comparison with a 9% core tier 1 capital target under stress conditions will be required to submit funding plans and to increase their capital to the extent possible by recourse to private investors; (iii) institutions borrowing from the Central Bank of Cyprus (CBC) will establish and submit quarterly medium-term funding plans, taking into consideration the expected path of deleveraging that would avoid asset fire sales or a credit crunch; (iv) CBC will review its prudential regulations on liquidity by end-2014.
CSR3: Further improve the long-term sustainability and adequacy of the pensions system and address the high at-risk-of-poverty rate for the elderly. Ensure an increase in the effective retirement age, including through aligning the statutory retirement age with the increase in life expectancy.	**Cyprus has partially implemented CSR3:** › The Cyprus authorities took measures for a comprehensive pension reform encompassing both the Government Employees Pension System (GEPS) and the General Social Insurance System (GSIS). In January 2013, the statutory retirement age was increased by two years for the GEPS, while the minimum age for entitlement to an unreduced pension is being raised by 6 month per year in the GSIS to bring it into line with the statutory retirement age. Automatic adjustments for changes in life-expectancy will take place every five years from 2018 onwards and early retirement penalties of 0.5% per month are introduced under both systems. In addition, under the GEPS, the indexation of all pension benefits has been changed from wages to prices, while pension benefits are to be calculated on a pro-rata basis taking into account life-time service. Lump-sum payments accruing under the GEPS from 1 January 2013 onwards are now taxed as personal income

	with public sector employees having the option of turning the lump sum into an annuity. Pensions under both systems are frozen for the programme period. › The government will implement further measures, if necessary, by 1 January 2014, to ensure the long-term viability of the pension system. › No new measures have been taken to address the high at-risk-of-poverty rate for the elderly since those that have already been in place since 2008 and 2009.
CSR4: Complete and implement the national healthcare system without delay, on the basis of a roadmap, which should ensure its financial sustainability while providing universal coverage.	**Cyprus has partially implemented CSR4:** › In June 2012, the Council of Ministers approved a proposal for the implementation of the National Health Insurance System (NHIS). › As per MoU, an actuarial study is being carried out to assess the potential fiscal risks and benefits of the planned introduction of the National Health System (foreseen for 2015) and is to be available by the end of June 2013.
CSR5: Improve the skills of the workforce to reinforce their occupational mobility towards activities of high growth and high value added. Take further measures to address youth unemployment, with emphasis on work placements in companies and promotion of self-employment. Take appropriate policy measures on the demand side to stimulate business innovation.	**Cyprus has partially implemented CSR5:** › In order to improve the skills of the workforce and to promote productivity, Cyprus set up four post-secondary institutions which opened in September 2012. The demand for enrolment in these institutes has exceeded largely supply. It also further developed and is gradually implementing a competence-based system of vocational qualifications (SVQ). To improve basic skills and address the drop-out and ESL, Cyprus started the implementation in October 2012 of the New Modern Apprenticeship (NMA) system directed to young people between 14-25 years old. There is a lack of quantified objective regarding the number of apprentices. › With a view to promoting employment, a new incentive scheme was set up for the employment of the long-term unemployed while two schemes were envisaged to support youth employment (a scheme to provide subsidies to innovative business to hire young unemployed for 12 months, and a scheme to improve the employability of newly registered young unemployed). › Despite the existence of a national Lifelong Learning Strategy (2007-2013), the lifelong learning rate is below EU average (7.5% compared to 8.9% in 2011) and limits the capacity for addressing skill mismatches. Reaching the national target of 12% participation in LLL by 2020 calls also for reinforced efforts and a more ambitious policy. › The effective integrated delivery of guidance and counselling services cutting across the education and employment areas is lacking. The set-up of a consultative national forum for lifelong guidance was approved in March 2012 with the mandate of promoting a shared national policy in this area. › To anticipate the possible labour needs for the energy sector, a recent study undertaken by the Human Resource Development Authority, provides an early identification of employment and training needs for the effective utilisation of natural gas in Cyprus.
CSR6: Remove unjustified obstacles in services markets, in particular by improving the implementation of the Services Directive in service sectors with the most growth potential (including tourism) and by opening up the provision of professional services.	**Cyprus has partially implemented CSR6**: › Cyprus adopted legislation for eliminating: (i) restrictions for the exercise of the profession of opticians; (ii) minimum tariffs for tourist guides and tourism agencies; and (iii) barriers to entry to the technical professions as a legal person. › Cyprus committed to removing obstacles in services markets by easing the requirements related to entry and establishment, and by eliminating requirements concerning minimum tariffs unless justified by overriding reasons of

	public interest and proportionate. Full implementation of the Service Directive is anticipated by first half of 2013. Concerning regulated professions, a comprehensive review of the requirements affecting access to and exercise of the activities in question will be carried out, while those requirements that are not justified by overriding reasons of public interest and proportionate will have to be eliminated. A reinvigoration of the tourism sector's competitiveness is foreseen. The Tourism Strategy for 2011-2015 will be revisited.
CSR7: Improve competitiveness, through the reform of the system of wage indexation, in consultation with social partners and in line with national practices, to better reflect productivity developments. Take steps to diversify the structure of the economy. Redress the fiscal balance by restraining expenditure.	**Cyprus has partially implemented CSR7:** › Cyprus adopted legislation to reform the wage indexation mechanism (COLA) by reducing the frequency of its adjustment (once instead of twice a year), introducing a mechanism for its automatic suspension during adverse economic conditions and moving from full to partial indexation of 50% of past inflation. COLA is suspended in the public sector until end-2015 while the new system is expected to be extended also to the private sector by means of a tripartite agreement. › Cyprus committed to achieving annual general government balance targets in each respective year during the programme period. These targets have been embedded in the 2013 Budget Law while the adopted MTBF 2013-2015 lays down medium-term budget projections and binding expenditure ceilings for each government entity.

5. CONCLUSION

Cyprus has already made important progress in implementing the policies laid down in the MoU. The authorities adopted sizeable fiscal consolidation measures prior to the Programme's signature and policies set as prior actions have been met. Key challenges and risks in the period ahead relate to developments in domestic credit conditions and to the complexity of the reorganisation of the financial sector with possible spillovers onto related professional and financial services, as well as the rapidly deteriorating labour market conditions. Upside risks relate to potential investment activity in the energy sector. More generally, the transition to a more diversified growth model will be challenging for the economy in the coming years and will imply a re-allocation of economic resources across sectors, which will take time and will require flexible factor and product markets. Maintaining proper implementation of Structural and other EU Funds, as well as increasing job opportunities for young people and preserving their employability prospects will contribute to laying the foundations for a sustainable long-term growth for Cyprus. It is essential that the policy measures under the MoU continue to be consistently implemented.

ANNEX

Table I. Sustainability indicators

	CY		EU27	
	No-policy change scenario	**Programme (SCP) scenario**	**No-policy change scenario**	**Programme (SCP) scenario**
S2	9.0	:	3.0	1.3
of which:				
Initial budgetary position (IBP)	3.2	:	0.8	-0.9
Long-term cost of ageing (CoA)	5.8	:	2.2	2.2
of which:				
Pensions	5.9	:	1.0	1.1
Health care	0.3	:	0.9	0.8
Long-term care	0.1	:	0.6	0.6
Others	-0.4	:	-0.4	-0.3
S1 (required adjustment)*	9.8	:	2.2	0.5
of which:				
Initial budgetary position (IBP)	4.7	:	0.0	-1.8
Debt requirement (DR)	3.8	:	1.9	1.9
Long-term cost of ageing (CoA)	1.3	:	0.3	0.4
S0 (risk for fiscal stress)**	0.59		:	
Debt, % of GDP (2012)	85.8		87.0	
Age-related expenditure, % of GDP (2012)	17.7		25.8	

Note:
The 'No-policy change' scenario depicts the sustainability gap under the assumption that the budgetary position evolves according to the Commissions' spring 2013 forecast until 2014. The 'Programme (SCP)' scenario depicts the sustainability gap under the assumption that the budgetary plans in the programme are fully implemented.
* The required adjustment of the primary balance until 2020 to reach a public debt of 60% of GDP by 2030.
** The critical threshold for the S0 indicator is 0.44.

Source :
Commission services; 2013 stability programme.

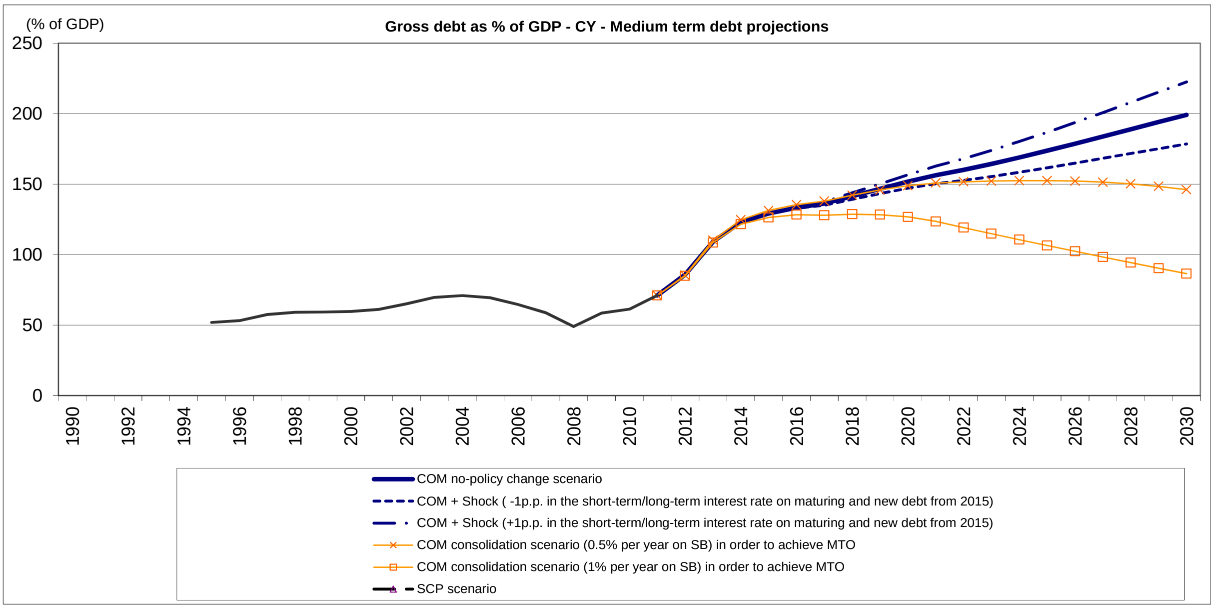

Table II. Taxation indicators

	2002	2006	2008	2009	2010	2011
Total tax revenues (incl. actual compulsory social contributions, % of GDP)	30.9	35.8	38.6	35.3	35.6	35.2
Breakdown by economic function (% of GDP)[1]						
Consumption	11.9	14.7	15.2	13.5	13.4	12.7
of which:						
- VAT	6.6	9.7	10.6	9.2	9.2	8.4
- excise duties on tobacco and alcohol	0.9	1.4	1.3	1.3	1.3	1.3
- energy	1.0	1.8	1.6	1.6	1.8	2.0
- other (residual)	3.4	1.7	1.8	1.4	1.1	1.0
Labour employed	9.9	11.0	11.0	12.2	12.5	12.5
Labour non-employed	0.1	0.1	0.1	0.1	0.1	0.1
Capital and business income	7.4	7.7	9.7	7.8	7.6	8.1
Stocks of capital/wealth	1.6	2.3	2.6	1.7	1.9	1.7
p.m. Environmental taxes[2]	3.0	3.3	3.2	2.9	2.9	2.9
VAT efficiency[3]						
Actual VAT revenues as % of theoretical revenues at standard rate	66.9	87.8	91.4	79.9	79.2	72.0

Note:

1 Tax revenues are broken down by economic function, i.e. according to whether taxes are raised on consumption, labour or capital. See European Commission (2013) Taxation trends in the European Union, for a more detailed explanation.

2 This category comprises taxes on energy, transport and pollution and resources included in taxes on consumption and capital.

3 The VAT efficiency is measured via the VAT revenue ratio. The VAT revenue ratio is defined as the ratio between the actual VAT revenue collected and the revenue that would theoretically be raised if VAT was applied at the standard rate to all final consumption. A low ratio can indicate a reduction of the tax base due to large exemptions or the application of reduced rates to a wide range of goods and services ('policy gap') or a failure to collect all tax due to e.g. fraud ('collection gap'). See European Commission (2012), Tax reforms in EU Member States, European Economy 6/2012 and Taxation Papers 34/2012 for a more detailed explanation.

Source: Commission

Table III. Financial market indicators

	2008	2009	2010	2011	2012
Total assets of the banking sector (% of GDP)	688.2	827.3	775.4	731.9	717.2
Share of assets of the five largest banks (% of total assets)	63.8	64.9	64.2	61.5	…
Foreign ownership of banking system (% of total assets)	38.1	37.0	…	…	…
Financial soundness indicators:					
- non-performing loans (% of total loans)[1)]	3.6	4.5	5.6	9.6	15.5
- capital adequacy ratio (%) [1)]	11.0	12.1	12.5	8.3	9.4
- return on equity (%) [1)]	14.5	14.0	11.0	-68.2	-33.2
Bank loans to the private sector (year-on-year % change)	25.5	10.6	5.9	6.9	4.2
Lending for house purchase (year-on-year % change)	21.8	11.5	13.4	4.8	0.3
Loan to deposit ratio	109.4	114.0	105.0	112.7	119.4
CB liquidity as % of liabilities	4.3	5.9	4.3	4.6	8.7
Banks' exposure to countries receiving official financial assistance (% of GDP)	…	…	…	…	…
Private debt (% of GDP)	261.9	288.3	291.2	308.5	324.6
Gross external debt (% of GDP)					
- Public	…	…	…	…	…
- Private	…	…	…	…	…
Long term interest rates spread versus Bund (basis points)*	0.6	1.4	1.9	3.2	5.5
Credit default swap spreads for sovereign securities (5-year)*	…	…	…	…	…

Notes:

[1)] Latest data (September 2012).

* Measured in basis points.

Source:

Bank for International Settlements and Eurostat (exposure to macro-financially vulnerable countries), IMF (financial soundness indicators), Commission (long-term interest rates), World Bank (gross external debt) and ECB (all other indicators).

Table IV. Labour market and social indicators

Labour market indicators	2007	2008	2009	2010	2011	2012
Employment rate (% of population aged 20-64)	76.8	76.5	75.3	75.0	73.4	70.2
Employment growth (% change from previous year)	3.2	2.1	-0.4	-0.2	0.4	-4.1
Employment rate of women (% of female population aged 20-64)	67.7	68.2	68.3	68.8	67.7	64.8
Employment rate of men (% of male population aged 20-64)	86.4	85.2	82.8	81.7	79.6	76.1
Employment rate of older workers (% of population aged 55-64)	55.9	54.8	55.7	56.3	54.8	50.7
Part-time employment (% of total employment, 15 years and more)	7.3	7.8	8.6	9.5	10.2	10.7
Part-time employment of women (% of women employment, 15 years and more)	10.9	11.4	12.4	12.7	12.9	13.7
Part-time employment of men (% of men employment, 15 years and more)	4.4	4.8	5.3	6.8	7.7	8.0
Fixed term employment (% of employees with a fixed term contract, 15 years and more)	13.2	13.9	13.8	14.0	14.1	15.1
Transitions from temporary to permanent employment	2.8	2.1	2.1	2.5	:	:
Unemployment rate1 (% of labour force, age group 15-74)	3.9	3.7	5.4	6.3	7.9	11.9
Long-term unemployment rate2 (% of labour force)	0.7	0.5	0.6	1.3	1.6	3.6
Youth unemployment rate (% of youth labour force aged 15-24)	10.2	9.0	13.8	16.6	22.4	27.8
Youth NEET rate (% of population aged 15-24)	9.0	9.7	9.9	11.7	14.6	16.0
Early leavers from education and training (% of pop. 18-24 with at most lower sec. educ. and not in further education or training)	12.5	13.7	11.7	12.7	11.3	11.4
Tertiary educational attainment (% of population 30-34 having successfully completed tertiary education)	46.2	47.1	45.0	45.3	46.2	49.9
Formal childcare (from 1 to 29 hours; % over the population less than 3 years)	6.0	8.0	8.0	11.0	7.0	:
Formal childcare (30 hours or over; % over the population less than 3 year)	12.0	18.0	14.0	13.0	16.0	:
Labour productivity per person employed (annual % change)	1.8	1.4	-1.5	1.5	0.1	1.7
Hours worked per person employed (annual % change)	-0.5	-0.5	-0.5	0.4	0.1	0.7
Labour productivity per hour worked (annual % change; constant prices)	2.3	1.9	-1.0	1.1	0.0	1.1
Compensation per employee (annual % change; constant prices)	-1.3	-1.3	2.4	0.6	0.5	-0.3
Nominal unit labour cost growth (annual % change)	1.2	1.8	4.1	1.0	3.2	-0.1
Real unit labour cost growth (annual % change)	-3.0	-2.7	4.0	-0.9	0.5	-2.0

Notes:

[1] Unemployed persons are all persons who were not employed, had actively sought work and were ready to begin working immediately or within two weeks. The labour force is the total number of people employed and unemployed.

[2] Long-term unemployed are unemployed persons for at least 12 months.

Sources:
Commission (EU Labour Force Survey and European National Accounts)

Expenditure on social protection benefits (% of GDP)	2006	2007	2008	2009	2010
Sickness/Health care	4.64	4.51	4.47	5.07	4.99
Invalidity	0.71	0.66	0.68	0.75	0.74
Old age and survivors	8.33	8.26	8.39	9.25	9.74
Family/Children	1.94	1.93	2.07	2.19	2.12
Unemployment	1.22	0.91	1.04	1.00	1.06
Housing and Social exclusion n.e.c.	0.49	0.63	0.82	1.11	1.12
Total	18.17	17.84	18.57	20.79	21.31
of which: means tested benefits	1.61	1.83	2.22	2.75	3.01
Social inclusion indicators	**2007**	**2008**	**2009**	**2010**	**2011**
At-risk-of-poverty or social exclusion[1] (% of total population)	25.2	23.3	23.5	23.5	23.7
At-risk-of-poverty or social exclusion of children (% of people aged 0-17)	20.8	21.5	20.2	20.3	22.1
At-risk-of-poverty or social exclusion of elderly (% of people aged 65+)	55.6	49.3	48.6	43.0	40.6
At-Risk-of-Poverty rate[2] (% of total population)	15.5	15.9	15.8	15.1	14.5
Severe Material Deprivation[3] (% of total population)	13.3	9.1	9.5	10.1	10.8
Share of people living in low work intensity households[4] (% of people aged 0-59)	3.7	4.5	4.0	4.6	4.6
In-work at-risk-of poverty rate (% of persons employed)	6.3	6.3	6.8	6.7	7.3
Impact of social transfers (excluding pensions) on reducing poverty	26.2	30.6	33.1	36.0	38.3
Poverty thresholds, expressed in national currency at constant prices[5]	9609	9411	9257	9241	9427
Gross disposable income (households)	11303	12464	12476	13235	12847
Relative median poverty risk gap (60% of median equivalised income, age: total)	19.7	15.3	17.2	17.5	18.9

Notes:

[1] People at-risk-of poverty or social exclusion (AROPE): individuals who are at-risk-of poverty (AROP) and/or suffering from severe material deprivation (SMD) and/or living in household with zero or very low work intensity (LWI).

[2] At-risk-of poverty rate (AROP): share of people with an equivalised disposable income below 60% of the national equivalised median income.

[3] Share of people who experience at least 4 out of 9 deprivations: people cannot afford to i) pay their rent or utility bills, ii) keep their home adequately warm, iii) face unexpected expenses, iv) eat meat, fish, or a protein equivalent every second day, v) enjoy a week of holiday away from home once a year, vi) have a car, vii) have a washing machine, viii) have a colour tv, or ix) have a telephone.

[4] People living in households with very low work intensity: share of people aged 0-59 living in households where the adults (excluding dependent children) work less than 20% of their total work-time potential during the previous 12 months.

[5] For EE, CY, MT, SI, SK, thresholds in nominal values in Euros; HICP - index 100 in 2006 (2007 survey refers to 2006 incomes)

Sources:
For expenditure for social protection benefits ESSPROS; for social inclusion EU-SILC.

Table V. Product market performance and policy indicators

Performance indicators	2003-2007	2008	2009	2010	2011	2012
Labour productivity[1] total economy (annual growth in %)	1.2	1.4	-1.5	1.5	0.1	1.7
Labour productivity[1] in manufacturing (annual growth in %)	-2.3	3.3	-3.7	1.4	1.1	-0.2
Labour productivity[1] in electricity, gas, steam and air conditioning supply (annual growth in %)	-2.0	3.1	-2.7	-4.1	-0.1	n.a.
Labour productivity[1] in the construction sector (annual growth in %)	1.4	-0.4	-14.7	-2.6	-5.7	-5.7
Total number of patent[2] applications per million of labour force	24.1	28.3	30.4	34.6	n.a.	n.a.
Policy indicators	**2003-2007**	**2008**	**2009**	**2010**	**2011**	**2012**
Enforcing contracts[3] (days)	n.a.	735	735	735	735	735
Time to start a business[3] (days)	n.a.	8	8	8	8	8
R&D expenditure (% of GDP)	0.4	0.4	0.5	0.5	0.5	n.a.
Tertiary educational attainment (% of 30-34 years old population)	42.8	47.1	45.0	45.3	46.2	49.3
Total public expenditure on education (% of GDP)	7.01	7.45	7.98	7.92	n.a.	n.a.
	2007	**2008**	**2009**	**2010**	**2011**	**2012**
Product market regulation[4], Overall (Index; 0=not regulated; 6=most regulated)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Product market regulation[4], Retail (Index; 0=not regulated; 6=most regulated)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Product market regulation[4], Network Industries[5] (Index; 0=not regulated; 6=most regulated)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.

Notes:

[1] Labour productivity is defined as gross value added (in constant prices) divided by the number of persons employed.

[2] Total number of patent applications to the European Patent Office (EPO) per million of labour force

[3] The methodologies, including the assumptions, for this indicator are presented in detail on the website http://www.doingbusiness.org/methodology.

[4] The methodologies of the product market regulation indicators are presented in detail on the website http://www.oecd.org/document/1/0,3746,en_2649_34323_2367297_1_1_1_1,00.html. The latest available product market regulation indicators refer to 2003 and 2008, except for Network Industries.

[5] Aggregate Energy, Transport and Communications Regulation (ETCR).

*figure for 2007.

Source :
Commission, World Bank - *Doing Business* (for enforcing contracts and time to start a business) and OECD (for the product market regulation indicators).

Table VI. Green Growth

		2002-2006	2007	2008	2009	2010	2011
Green Growth performance							
Macroeconomic							
Energy intensity	kgoe / €	0.23	0.21	0.22	0.22	0.21	0.20
Carbon intensity	kg / €	0.98	0.90	0.86	0.86	0.82	n.a.
Resource intensity (reciprocal of resource productivity)	kg / €	1.59	1.60	2.03	1.95	n.a.	n.a.
Waste intensity	kg / €	n.a.	n.a.	0.14	n.a.	0.18	n.a.
Energy balance of trade	% GDP	-3.9%	-5.7%	-7.1%	-5.1%	-6.6%	-7.5%
Energy weight in HICP	%	n.a.	11	12	12	11	9
Difference between change energy price and inflation	%	n.a.	-1.5	12.5	-16.5	18.9	14
Environmental taxes over labour taxes	ratio	32.7%	31.5%	28.8%	23.6%	22.8%	n.a.
Environmental taxes over total taxes	ratio	10.6%	8.5%	8.3%	8.2%	8.1%	n.a.
Sectoral							
Industry energy intensity	kgoe / €	0.28	0.21	0.22	0.19	0.18	n.a.
Share of energy-intensive industries in the economy	% GDP	5.8	5.8	5.3	5.2	n.a.	n.a.
Electricity prices for medium-sized industrial users**	€ / kWh	n.a.	0.14	0.16	0.13	0.16	0.19
Gas prices for medium-sized industrial users***	€ / kWh	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Public R&D for energy	% GDP	n.a.	0.00%	0.00%	0.00%	0.00%	0.00%
Public R&D for the environment	% GDP	n.a.	0.00%	0.01%	0.01%	0.00%	0.00%
Recycling rate of municipal waste	ratio	11.0%	12.8%	12.8%	12.9%	19.8%	n.a.
Share of GHG emissions covered by ETS*	%	n.a.	48.5%	50.3%	50.0%	49.3%	n.a.
Transport energy intensity	kgoe / €	n.a.	0.93	0.93	0.91	n.a.	n.a.
Transport carbon intensity	kg / €	n.a.	2.01	2.02	2.03	n.a.	n.a.
Security of energy supply							
Energy import dependency	%	n.a.	95.9%	97.5%	96.4%	100.8%	92.6%
Diversification of oil import sources	HHI	n.a.	0.15	0.13	0.06	0.05	n.a.
Diversification of energy mix	HHI	n.a.	0.92	0.91	0.92	0.91	0.91
Share renewable energy in energy mix	%	n.a.	2.6%	3.2%	3.5%	3.8%	4.7%

Country-specific notes:
The year 2012 is not included in the table due to lack of data.
General explanation of the table items:
Source: Eurostat unless indicated otherwise; ECFIN elaborations indicated below
All macro intensity indicators are expressed as a ratio of a physical quantity to GDP (in 2000 prices)
Energy intensity: gross inland energy consumption (in kgoe) divided by GDP (in EUR)
Carbon intensity: Greenhouse gas emissions (in kg CO2 equivalents) divided by GDP (in EUR)
Resource intensity: Domestic Material Consumption (in kg) divided by GDP (in EUR)
Waste intensity: waste (in kg) divided by GDP (in EUR)
Energy balance of trade: the balance of energy exports and imports, expressed as % of GDP
Energy weight in HICP: the share of the "energy" items in the consumption basket used in the construction of the HICP
Difference between energy price change and inflation: energy component of HICP, and total HICP inflation (annual %-change)
Environmental taxes over labour or total taxes: from DG TAXUD's database "Taxation trends in the European Union"
Industry energy intensity: final energy consumption of industry (in kgoe) divided by gross value added of industry (in 2005 EUR)
Share of energy-intensive industries in the economy: share of gross value added of the energy-intensive industries in GDP
Electricity and gas prices medium industrial users: consumption band 500 - 2000MWh and 10000 - 100000 GJ; figures excl. VAT.
Recycling rate of municipal waste: ratio of municipal waste recycled over total municipal waste
Public R&D for energy or for the environment: government spending on R&D (GBAORD) for these categories as % of GDP
Share of GHG emissions covered by ETS: based on greenhouse gas emissions as reported by Member States to EEA (excl LULUCF)
Transport energy intensity: final energy consumption of transport activity (kgoe) divided by transp industry gross value added (2005 EUR)
Transport carbon intensity: greenhouse gas emissions in transport activity divided by gross value added of the transport sector
Energy import dependency: net energy imports divided by gross inland energy consumption incl. energy consumption international bunkers
Diversification of oil import sources: Herfindahl index (HHI), calculated as the sum of the squared market shares of countries of origin
Diversification of the energy mix: Herfindahl Index over natural gas, total petrol products, nuclear heat, renewable energies and solid fuels
Share renewable energy in energy mix: %-share in gross inland energy consumption, expressed in tonne oil equivalents
*Provisional figures provided by DG CLIMA. Final figures will be available on 15/04.
** For 2007 average of S1 & S2 for DE, LU, NL, FI, SE & UK. Other countries only have S2.
*** For 2007 average of S1 & S2 for IT, NL, FI, SE & UK. Other countries only have S2.