

# European Semester

2012/2677(RSP) - 30/05/2012 - Follow-up document

**PURPOSE:** draft recommendation for a COUNCIL RECOMMENDATION on Cyprus's 2012 national reform programme and delivering a Council opinion on Cyprus's convergence programme for 2012-2015.

**BACKGROUND:** the European Commission has adopted a **package of recommendations for budgetary measures and economic reforms** to enhance financial stability, boost growth and create employment across the EU.

The recommendations are **country-specific**, taking account of the individual situation of each Member State. The Commission has also issued recommendations for the euro area as a whole. The country-specific recommendations put forward by the Commission give operational guidance for Member States while preparing their budgetary policies and for economic reforms that should be enacted over the coming twelve months to boost competitiveness and facilitate job creation.

The adoption of the recommendations marks the **concluding of the second phase of the European Semester** of economic policy coordination, which was launched with the Commission's [Annual Growth Survey](#) on 23 November 2011.

The basis for these recommendations is a thorough assessment of the implementation of those adopted in 2011, combined with a detailed analysis of the national reform programmes and stability or convergence programmes that Member States submitted by 30 April 2012. The analysis underpinning the recommendations is presented in 28 Commission staff working documents.

**CONTENT:** on 7 May 2012, **Cyprus** submitted its stability programme covering the period 2012-2015 and on 10 May 2012, its 2012 national reform programme. The two programmes have been assessed at the same time.

Based on the assessment of the 2012 stability programme, the Council is of the opinion that the macroeconomic scenario underpinning the budgetary projections in the **stability programme appears optimistic** in 2012-2014. Although incorporating a major downward revision of the growth outlook, the macroeconomic scenario remains subject to downside risks, relating in particular to the evolution of domestic demand in 2012-2013. The objective of the budgetary strategy outlined in the programme is to **correct the excessive deficit by 2012 and to reach the medium term budgetary objective (MTO) by 2014, and to stay at MTO in 2015**. The programme confirms the previous MTO of a balanced budget in structural terms, which adequately reflects the requirements of the Stability and Growth Pact.

According to the programme, the debt-to-GDP ratio, which amounted to 71.6% in 2011, is to increase to 72.1% in 2012 before gradually dropping to 65.4% in 2015.

The Commission states that the **main challenges facing Cyprus** are as follows:

- Tax administration is inefficient as administrative costs in relation to revenue collection in Cyprus are very high. Tax collection is relatively low.
- Given the wide exposure of Cyprus's banking institutions to the Greek economy, total exposure of the consolidated Cypriot banking sector to Greece is very high. Progress with the strengthening of supervision of the cooperative credit societies, which hold about 40% of all domestic deposits, has so far not been satisfactory.

- Cyprus faces challenges in ensuring the long-term sustainability of public finances, notably in the area of pensions. In terms of poverty of the elderly, Cyprus has only partly addressed their high at-risk-of-poverty rate.
- Inequity and inefficiencies in the healthcare sector have not been tackled in a meaningful manner.
- The Cypriot government took some steps to respond to the 2011 recommendation on wage indexation (cost of living allowance - COLA), notably by adopting a two-year pay freeze in the broader public sector. The government and social partners also agreed to initiate a dialogue with the aim of reviewing the COLA system by the end of June 2012.
- The worsening of the macroeconomic outlook adversely affected the Cypriot labour market, raising the unemployment rate and causing a large increase in youth unemployment.
- As regards the service sector, Cyprus transposed the Services Directive by way of a horizontal law accompanied by a number of sector-specific amending laws and regulations. However, in some sectors (e.g. retail, tourism, and construction services) the adoption of sector-specific legislation is still pending.

### **Recommendations proposed for Cyprus (2012-2013):**

#### **Budgetary measures:**

- take additional measures to achieve a durable correction of the excessive deficit in 2012 ;
- rigorously implement the budgetary strategy, 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 improve tax compliance and fight against tax evasion ;
- harmonise the supervision of 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.

#### **Pensions and health care:**

- further improve the long-term sustainability and adequacy of the pensions system and address the high at-risk-of-poverty rate for the elderly ;
- align the statutory retirement age with the increase in life expectancy ;
- complete and implement the national healthcare system without delay, on the basis of a roadmap, which should ensure universal coverage.

#### **Labour market:**

- 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.

#### **Services and competitiveness:**

- 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);

- ▾ improve competitiveness including through the reform of the system of wage indexation, in consultation with social partners;
- take steps to diversify the structure of the economy and redress the fiscal balance by restraining expenditure.

The recommendations are to be endorsed by the European Council on 28-29 June and formally adopted by the Council in July 2012.