

# Cyprus Industry and the European Union



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KIBRISTA SOSYALIST  
GERÇEK LONDRA BURÖSÜ

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## I. The development of Cyprus industry

During the initial stages of development (1960-1970) the small size of the domestic market exerted a decisive influence on the structure, size and orientation of the industrial sector of the island. Until the end of the sixties local industry was more concerned to satisfy local demand and showed little interest in exports. The Government's policy was primarily geared towards securing the local market for local industry and encouraged import substitution rather than export promotion as an instrument to growth. To this end high import duties and tight import control measures were introduced, especially on consumer goods.

During this period the manufacturing industry contributed little more than a tenth to GDP and only a fifth of commodity exports. Processed food and drinks, building materials and a variety of light consumer industries made up the bulk of manufacturing output.

From 1970 onwards there were signs of growing diversification of production away from agriculture and primary product processing towards furniture, building materials, clothing, footwear, leather goods etc. Export demand was beginning to become an important factor for industry as industrial output and productivity started to display high growth rates. At the same time it was becoming apparent that a sheltered domestic market would potentially cause problems on the supply side and hence threaten to put a break on the growth of the industrial sector.

It was therefore felt that strengthening the relationship with the European Community (EC) via an Association Agreement which would entail reciprocal concessions would serve to increase Cyprus exports while it could provide the framework for the gradual opening up of the local market.

## II. The evolution of relations between

### Cyprus and the EC

The goal of the Government to establish close trade relations with the European Community, evolved through several stages. There was an attempt to establish relations with the EC in the early sixties (parallel to the first UK application), which was not realized. As it is known, Cyprus had close economic ties with Great Britain inside the Commonwealth. Therefore, UK membership of the EC would signify the end of the trade preferences Cypriot products enjoyed in the British market which was the main export market for Cyprus.

Next, Cyprus moved to establish an Association with the European Community again as soon as the UK made its own second effort in the early seventies.



The Association Agreement between Cyprus and the EC, signed on 19 December 1972, contained a provision to proceed to full Customs Union following a transition period in two stages.

Unpredictably, the interposition of the Turkish military invasion in 1974 and the occupation of part of Cyprus thwarted all timetables. Thus, the first stage was prolonged and the Government of the Republic of Cyprus requested new negotiations with the EC with a view to entering into the Second Stage.

The negotiations were concluded in May 1987, with the signing of a Proto-

col. According to this Protocol, Customs Union would occur at the end of a two-phase period, each phase lasting ten and four or five years, respectively. In July 1990 the Government of the Republic of Cyprus applied for full membership to the European Community.

The European Commission's opinion endorsed by the Council, was issued in June 1993. The Opinion reiterates Cyprus' European identity and dwells upon the cultural, political, economic and social life on the Island, stating that «... all these confer on Cyprus beyond all doubt, its European identity and character and confirm its vocation to belong to the Community». In the light of the above the General Affairs Council Meeting that took place in Brussels on the 6th March 1995 decided that accession negotiations with Cyprus «will start on the basis of Commission proposals six months after the conclusion of the 1996 Intergovernmental Conference, taking account of the results of the Conference».

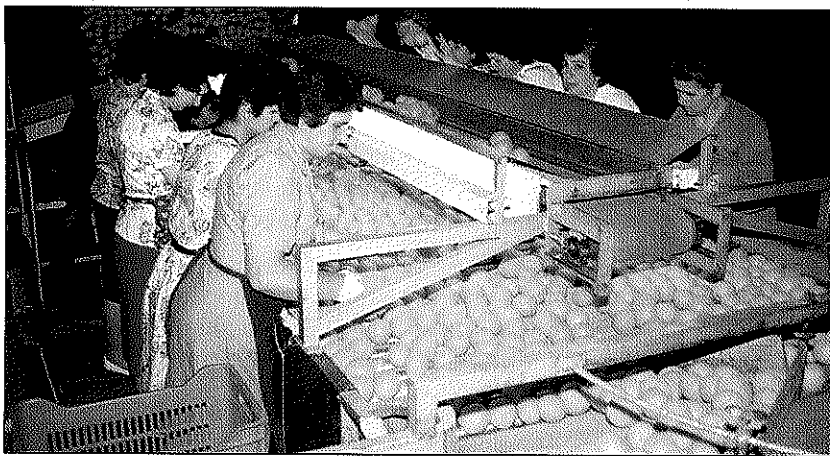
### **III. The Customs Union Agreement between Cyprus and the EC: Basic provisions concerning the industrial sector**

The liberalisation of trade through reciprocal abolition of customs duties between Cyprus and the European Community meant that their trade exchanges were expected to lead to the expansion and strengthening of trade exchanges between the two parties.

By virtue of the Agreement, Cyprus will gradually reduce during the first phase i.e. by 1998 all duties, and will abolish all other restrictions on imports of industrial products originating in the European Union. By the end of the first phase Cyprus will also introduce the European Union's Common External Tariff for imports of industrial products from third countries.

A limited number of industrial products' categories are exempted from the tariff dismantling process. These products include chocolates, biscuits, beer, spirits, cement, ice-cream, petroleum products etc. Moreover, during this phase Cyprus would maintain import duties for a number of agro-industrial products such as wines, orange juice, grape juice, canned fruits.

The Protocol permits Cyprus to maintain quantitative ceilings for the im-



ports in Cyprus of certain industrial products. However, as from 1996 onwards all such quantitative restrictions have been abolished following Cyprus' commitments to the World Trade Organization.

Cyprus' industrial exports to the EC already enjoy duty free access, provided the rules of origin criteria are satisfied. Rules of origin generally require raw materials imported (from outside the EC) to undergo a certain degree of processing, so that the final product produced benefits from the duty free regime upon exportation to the EC markets.

Rules of origin can be restrictive to trade for certain products, mainly clothing, as far as they use fabrics imported from non-EC countries. Nevertheless, a number of such clothing products have been exempted from the processing criteria and can gain duty free access upon exportation to the EC.

## IV. Most important structural features of the manufacturing industry

The broad industry sector accounts today for 25% of the GNP while the share of manufacturing industry to GNP is estimated in 1995 to have reached 13%.

In terms of employment 17% of the gainfully employed workforce is engaged in manufacturing activity.

The most important economic indicators of the manufacturing industries are presented below in Table 1.

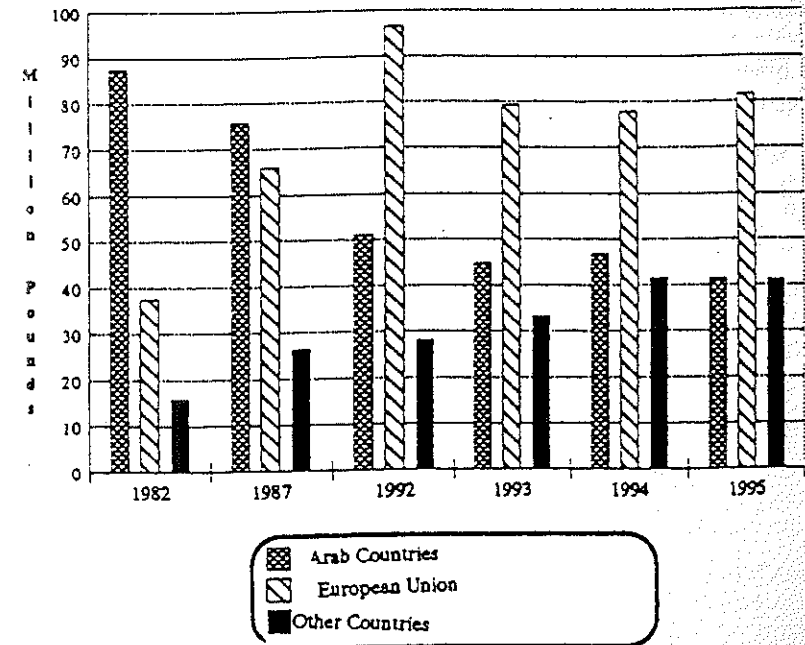
Indicators	1992	1993	1994	1995 (est.)
Employment (000 persons)	50,2	46,9	46,1	46,3
Gross output (CSm)	1.227,8	1.191,8	1.272,7	1.340,5
Value added (CSm)	486,2	490,7	525,9	561,0
Annual rate of growth (%)	3,7	-4,1	4,2	2,5

Source: Industrial Statistics 1995. (Dept. of Statistics and Research)

In terms of output the most important product groups are food and drinks, wearing apparel and footwear, wood and furniture, chemical products and non-metallic mineral products. With regard to exports, manufactured goods make up 70% of total domestic exports. Garments, pharmaceuticals, cement, wines, footwear, fruit and vegetable juices are the most important products exported.

As can be seen from figure 1 on page 11 during the last few years the geographic distribution destination of exports has been changing in favour of the European Union.

Fig. 1: Geographic distribution of manufactured exports



Source: Industrial Statistics 1995. (Dept. of Statistics and Research).



## V. Cyprus membership to the European Union and local manufacturing industry

There is no doubt that the Customs Union with the EC will in itself aggravate the competitive pressures on Cyprus' manufacturing industry. On the other hand protracted protection inhibits the development of competitive industries and hinders the growth potential of the economy.

The Government in cooperation with the private sector has embarked on a process of industrial restructuring in order to assist the local manufacturing industry to absorb smoothly the new competitive pressures and prepare it for accession to the European Union.

The pivot of restructuring efforts is the gradual introduction of flexible specialization in production. This entails, inter alia, advanced flexible machinery and automation, multi-skilled workforce, collective service centres to serve small and medium industries. A number of policy instruments have been geared to facilitate this process.

Moreover, accession to the European Union entails a number of additional benefits for Cypriot small and medium size industries which will enhance the prospects of restructuring.

Membership will primarily enable local industry to participate in a number of Community programmes concerning industrial technology, professional training, product development, marketing etc. Furthermore, small and medium enterprises will benefit from the Community's regional assistance schemes.

Another factor which contributes in making local industry more optimistic in view of membership is linked directly to the prospects of the single internal market. Unquestionably the liberalization of trade in terms of duties and quantitative restrictions offers significant leverage to Cypriot exports inside the large single market. Yet, it is likewise true that the potential for Cyprus will still be rather narrow, compared with what it could achieve as a full member of the Union. In this case the Government and the private sector alike will participate in the decision and policy-making of the Union.

Finally, another significant consideration is that entry to the EU can offer

considerable impetus to Cypriot industry by accelerating the influx of foreign investment which will be channelled with greater ease in view of the liberalisation of capital market.

On the other hand, Cyprus possesses a multiplicity of characteristics which render it attractive for investment. A specialized labour force, an exemplary infrastructure, stable social relations, professional skills, combined with geographical accessibility, comprise an assets package of considerable appeal.

The substantial advantages accruing to Cyprus from its entry to the EU should not in the least overshadow the considerable responsibilities EU membership will entail for the Cypriot economy.

