



Simona Mihai-Yiannaki and Fiona Mullen

The Recovery Plan in Cyprus

Setting the course for a climate-neutral
and digital future?

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About this publication

The Covid-19 pandemic in Cyprus has led to a sharp fall in output but a smaller decline in employment, thanks to a range of government support schemes. The government has increased borrowing but without risking a fiscal crisis. The crisis has already resulted in a long overdue acceleration of digitisation. The government's recovery plan is driven by the EU's Recovery and Resilience Facility, which is conditional on a range of reforms to speed up digitisation and the "greening" of the economy. Many of the requirements are reforms that the minority government has been trying to pass for years. With the EU now using "carrots" rather than "sticks", there is a greater chance that these long overdue transformations will be implemented.

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MACROECONOMIC EFFECTS

To date, the overall picture for the macroeconomic impact of Covid-19 on Cyprus is one of a sharp decline in output but a less severe average impact on labour, mainly owing to large-scale government support programmes that are only gradually being lifted. Real growth in gross domestic product (GDP) was already decelerating before the pandemic hit, having reached 3.2% in 2019, compared with 4.1% in 2018. The timing of the “hard lockdown” in April is reflected in a year-on-year real GDP contraction of 11.9% in the second quarter, following a decline of 0.8% in the first. In April alone, retail sales dropped by 25.2% compared with March but bounced back by 38.8% compared with the previous month in May. Tourism arrivals tumbled by 99.7% year on year in the second quarter and were still down by 85% in July-August. This is largely because the UK, which accounts for one-third of all arrivals, remained on the “Category B” list, which requires a negative polymerase chain reaction (PCR) Covid-19 test before travel, and Russia, which accounts for just under 20% of arrivals, has not progressed from the “Category C” list, which bars entry for all but a small category of citizens.

The government was running large and comfortable budget surpluses before Covid-19 hit but spent €1.3 billion between March and September on fiscal support for jobs, while pledging another €1.9 billion in liquidity support for banks. It also took advantage of low interest rates and the liquidity programmes of the European Central Bank to borrow heavily, and this lifted government debt to €24.4 billion at the end of June 2020 from €21.0 billion at the end of December 2019. However, the government was able to do this from a position of strength. Debts to the International Monetary Fund (IMF) and Russia had been paid back early and the government held €5 billion in cash reserves at the Central Bank of Cyprus as of July – enough to meet all debt obligations until at least the end of 2022. Banks are also far better capitalised, and non-performing loans, while still high by eurozone standards, had dropped by 68% between 2014 and 2019. The country also retained its investment-grade rating. These factors make the situation much less risky than 2013, the year of the Cyprus financial crisis.

The impact on the labour market has been tempered by the abovementioned increase in state spending, with total *employment* based on Labour Force Survey (LFS) data falling

year on year by only 0.1% in the second quarter, compared with the abovementioned 11.9% contraction in real GDP. The programmes have so far subsidised just under 189,000 salaried jobs or 76% of private employees (see Table 4). At first sight, women fared better than men as regards unemployment, as the total number of unemployed women actually declined by 34.5% year on year in the second quarter, whereas unemployment among men fell by 8.4%. However, a closer examination of the data leads to the conclusion that many women, especially under 24, simply dropped out of the labour force. The labour force for women aged 15-24 shrank by 14.1% in this period, while it grew by 0.8% for men. At the same time, the number of women of all ages defined as inactive (not looking for work or available for work) grew by 5.6%, while the number of inactive men grew by 2.0%. These figures are not disaggregated by age. However, when combined with other data showing a larger relative drop for women in part-time employment and on permanent contracts, it could indicate that younger women found themselves unable to work while children were not attending school. As regards employment by sector in the second quarter, men were harder hit in retail (9.7% year-on-year reduction for men and 5.9% for women), and tourism (29.4% men, 18.5% women). Women were harder hit in “other service activities” (10.3% increase for men, 23.3% decline for women).

EXISTING STRUCTURAL WEAKNESSES

Cyprus entered the crisis with weak productivity, competitiveness, quality of education, and energy efficiency (see Table 3) relative to the average in the European Union (EU). The performance is even worse if one takes into account Cyprus’ fairly higher average income levels. Among the various indicators, one major concern is the real labour productivity growth, which was less than a third of the EU27 average in 2010-19.

One likely reason for below-average indicators is the focus on construction investment, which is technology light. Therefore it is highly labour-intensive in Cyprus and contributes little to long-term sustainability compared with investment in technology or innovation, for example. Construction investment was encouraged by the Citizenship by Investment Programme (“golden passport” scheme), which was abolished on 13 October (effective 1 November). The

Table 1
Cyprus: main economic indicators

	2019 Year	2019 Q3	2019 Q4	2020 Q1	2020 Q2
GDP at current prices (EUR million) (a)	21,944	5,507	5,548	5,482	4,694
GDP per capita (EUR)	24,925	n/a	n/a	n/a	n/a
GDP growth (real % change, year on year) (a)	3.2	3.2	3.2	0.8	-11.9
Employment growth (% change, year on year) (b)	3.9	3.0	3.0	4.5	-1.1
Unemployment rate (% of labour force; Labour Force Survey)	7.1	6.7	6.3	7.3	6.8
Average earnings (nominal % change, year on year)	2.1	2.6	2.4	2.6	1.7
Harmonised consumer price inflation (% change, year on year)	0.6	0.1	0.2	0.6	-1.6
At risk of poverty rate (%)	22.3	n/a	n/a	n/a	n/a
– Women	23.3	n/a	n/a	n/a	n/a
– Men	21.1	n/a	n/a	n/a	n/a
General government budget balance (EUR million)	380	201.5	-437.1	-66.7	-551.7
Gross public debt (EUR million; end-period)	20,958	21,295	20,958	21,525	24,412
Exports of goods (nominal % change, year on year)	-10.5	-21.7	2.4	-21.7	4.8
Imports of goods (nominal % change, year on year)	-27.0	-5.6	-21.3	5.9	-26.9
Current-account balance (EUR million)	-1,474	-106	-461	-710	-182
Tourism arrivals (% change, year on year)	1.0	2.2	2.5	-31.0	-99.7
Retail sales volumes (% change, year on year)	3.1	4.3	5.6	5.6	-10.9
Motor vehicle registrations (% change, year on year)	-5.2	2.5	-2.0	-8.0	-40.3
Real estate sales (% change, year on year)	12.2	-2.7	3.7	-15.8	-59.9

(a) Quarterly data are seasonally and calendar-day adjusted. (b) National accounts basis.

Sources: Statistical Service (Cystat); Central Bank of Cyprus.

Table 2
Cyprus: labour indicators

	2019 Q2	2019 Q3	2019 Q4	2020 Q1	2020 Q2
Employment					
Total employment (national accounts definition)	440,682	446,810	441,719	436,848	435,693
Total employment (Labour Force Survey) (a)	418,374	417,118	421,303	417,057	418,015
– Women	197,275	193,035	198,596	196,801	196,349
– Men	221,099	224,082	222,707	220,256	221,666
– Total employment: under-25s	30,512	29,634	31,039	29,331	27,343
– Total employment: 25-54 year-olds	308,825	310,995	313,696	313,041	313,807
Unemployment					
Total unemployment rate (% of labour force; Eurostat) (b)	7.3	6.8	6.5	6.3	7.7
Total unemployment rate (% of labour force; Labour Force Survey) (a)	6.5	6.7	6.3	7.3	6.8
– Women	6.7	8.4	7.0	7.5	6.6
– Men	6.3	5.3	5.8	7.1	7.0
– Total unemployment: under-25s	14.9	15.6	16.0	14.5	17.8
– Total unemployment: 25-64 year-olds	5.9	6.1	5.6	6.8	6.1
Earnings					
Average earnings (nominal % change, year on year)	1.4	2.6	2.4	2.6	1.7
– Women	3.1	2.2	2.6	2.9	3.7
– Men	0.2	2.8	2.2	2.3	0.0

(a) The Labour Force Survey is the only source of disaggregated data. (b) Eurostat unemployment data are subject to frequent revision.

Sources: Statistical Service (Cystat); Central Bank of Cyprus.

Table 3
Structural and competitiveness indicators

	Cyprus	EU27
Energy intensity of the economy kgoe per 000 € in Purchasing Power Standard (PPS) in 2018	124.6	112.9
Share of fossil fuels in gross available energy in 2018	91.8	72.4
Share of electricity from renewable sources in total electricity generation in 2018	9.4	32.3
Electricity prices for small business (20-500 MWh) in 2019H2	0.1536	0.0973
World Bank Quality of Education ranking out of 137 countries in 2017	55	52
World Bank Ease of Doing Business ranking out of 190 countries in 2020	54	40
World Economic Forum Global Competitiveness Ranking out of 141 countries in 2019	44	32
Real labour productivity growth per person employed, 2010-19 average (%)	0.4	1.4
Current-account deficit as % of GDP, 2010-19 average (%)	-4.3	1.4

Sources: Eurostat, World Bank, World Economic Forum.

scheme generated around €9.7bn in transactions. However, according to a Ministry of Finance study of transactions in 2015-18, it generated only 0.4% of GDP per year in value-added (approximately €80m per year). The scandals relating to the passport scheme have now sparked a debate about where investment should be directed to and the need for a more sustainable economic model. The low starting point for structural indicators, combined with shifting public opinion, suggest that Cyprus stands to benefit from EU- and pandemic-related reforms (see below).

The EU's Cyprus Country Report for 2020 refers to several problematic areas that hinder environmental sustainability, energy efficiency and climate-neutrality and calls for a long-term comprehensive strategy, under an Integrated National Energy and Climate Plan (INECP). These are likely to be tackled with reference to the EU's Green Deal, which includes the ambitious goal of zero carbon dioxide (CO₂) emissions by 2050 from industries/new technologies and requires climate neutrality in policy development.

Indeed, the focus on construction investment has exacerbated the major ecological deficiencies, reflected in Table 3. These include heavy reliance on polluting energy, high electricity prices, low agricultural productivity (thanks to poor soil conditions among other issues) and lack of efficient and clean transportation or moves towards smart cities. The 13% target for the share of renewable energy sources (RES) in gross final energy consumption in Cyprus by 2020 was achieved, although without the anticipated 10% contribution from transport sector. Instead, a controversial but reportedly permitted calculation relating to the use of recycled air in air-conditioning units meant that the heating and cooling sector made up the difference.

With well over 90% of electricity still being produced by diesel and heavy fuel oil, and most of it planned to be replaced by imported liquefied natural gas (LNG), Cyprus will find it very challenging to meet new EU targets, however.

These include the national target under the Effort Sharing Regulation, which is to reduce emissions outside the EU's Emissions Trading System (ETS) by 24% in 2030.

Table 4
Cyprus economy-wide air pollutant emissions projections in the With Existing Measures (WEM) scenario until 2030

	kt	10.83	8.29	7.91
NO _x	kt	1.56	1.36	1.45
PM2.5	kt	3.64	0.71	0.66
SO ₂				

Source: Cyprus' Integrated National Energy and Climate Plan, January 2020, https://ec.europa.eu/energy/sites/ener/files/documents/cy_final_necp_main_en.pdf.

THE NATIONAL RECOVERY PLAN

Under the EU's €750bn Recovery and Resilience Facility (RRF) agreed by EU leaders in July 2020, Cyprus is entitled to €978m in (conditional) direct grants and, according to the Employers' and Industrialists' Federation (OEB), a total of €1.09 billion to address the Covid-19 pandemic, undertake green and digital transition and becoming more sustainable and resilient by 2026.

The aims of RRF are to:

1. Restore economic activity and employment, enhance social protection and achieve further social progress.
2. Strengthen the resilience of the economy and society, promote diversification and upgrade the economy's efficiency and productivity.
3. Foster the green and digital transition, in line with the EU's strategic goals.

The RRF funds are conditional on a range of reforms, starting with the submission of a national recovery plan. The Cyprus

National Recovery Plan is built around seven policy axes with the following objectives and indicative actions.

Policy Axis 1: Public health, civil protection and lessons learned from the pandemic. Complete the national health reform through education, accreditation and technology enhancement; improve hospitals' service quality, equipment, infrastructure and health system productivity; and promote the export of medical services by establishing Cyprus as a regional health hub.

Policy Axis 2: Labour market, social policy, education and human capital. The creation of a "one stop shop" (meaning citizens do not have to go abroad) for education and transferable skills. This involves upgrading technologies in education and enhancing education in science, technology, engineering, and mathematics (STEM) so that skills cater to business needs. This will be done in cooperation with Human Resources Development Authority (HRDA), which subsidises training and job placements, to support upskilling and reskilling in the private and public sector, flexible and teleworking, and vulnerable groups.

Policy Axis 3: New growth model and economic diversification. Redesign and diversify the economy; bring more technology to agriculture; promote the efficiency and branding of Cyprus products; enhance the use of biotech; promote the greening of tourism; develop tertiary education and attract more international students; establish key performance indicators (KPIs) for the use of government funds; fast-track innovative businesses and facilitate the commercialisation of ideas; connect with the Cypriot diaspora for synergies; and create centres of excellence.

Policy Axis 4: Foster an investment-friendly business environment, support small and medium-sized enterprises (SMEs) and promote public sector and judicial efficiency. Reduce red tape; fast-track investments; support SMEs via business clustering and promoting entrepreneurship; create traditional Cypriot products/services and promote them via economic diplomacy; provide more and better targeted financial instruments via banks; facilitate the use of the latest technologies, including robotics, 3D printing, and computer-aided design/manufacturing (CAD/CAM); introduce e-justice; and utilise the Temporary Framework for State Aid measures to support the economy in the current COVID-19 outbreak.

Policy Axis 5: Digital Efficiency and productivity. Create a digital transformation "factory"; increase digital connectivity, digitalise the public sector and businesses; enhance digital literacy, expand the government data warehouse; revamp government websites; increase the use of e-health; further digitalise the tax information system and the Company Registrar; unify public service computer centres and establish a government "cloud"; and create a "Digital Cyprus" using blockchain technologies.

Policy Axis 6: Accelerate the transition to a green economy. This includes energy efficiency; green tax reform; clean energy; sustainable transport; and waste and water sectors.

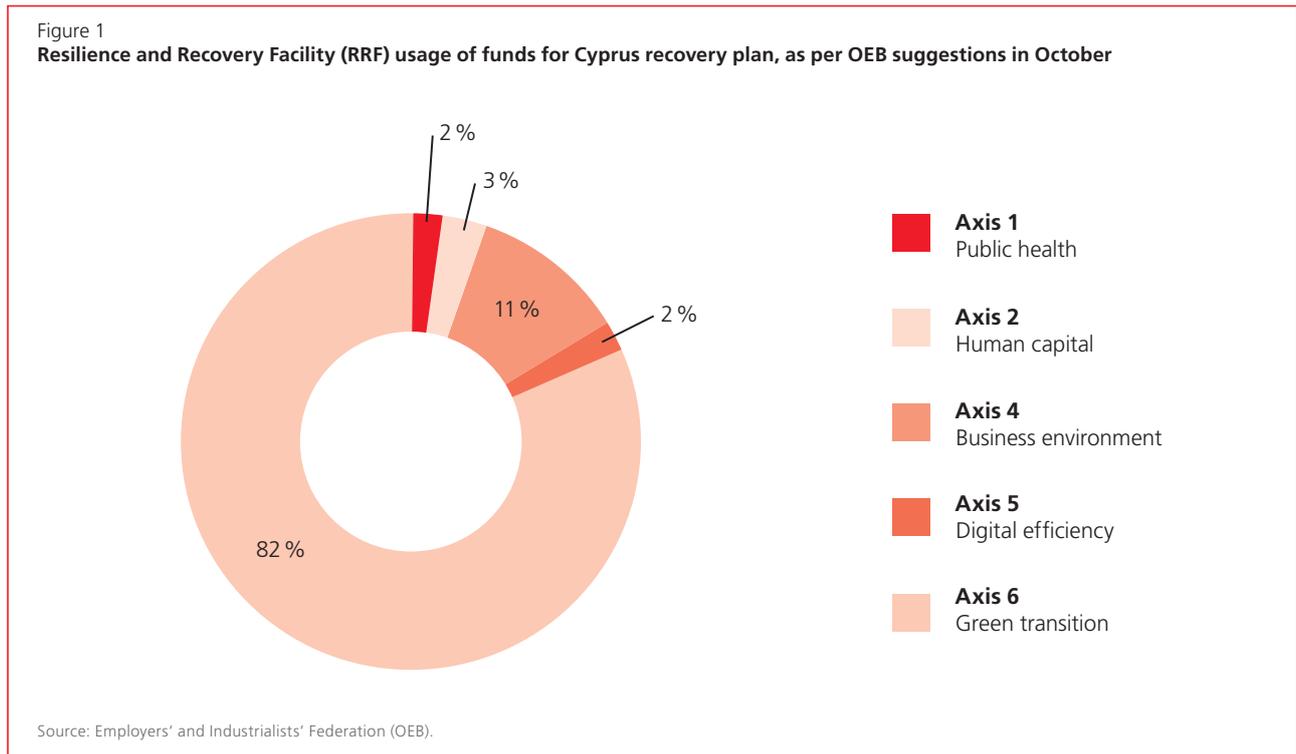
Policy Axis 7. Fiscal/financial. This relates to the budgetary aspects of the other pillars.

The implementation of environment-related reforms has to date been largely run by the following five institutions and these are likely to play a key part in the Cyprus National Recovery Plan.

1. Agricultural Research Institute. Priorities in land protection for agriculture; waste management and the "circular economy" concept; use of compost for improving soil; promoting rural clusters; dealing with extreme weather events due to climate change (fires, floods); promoting energy communities and energy efficiency in agriculture; managing water infrastructure and distribution; branding Cypriot products and their food origins; efficient use of water; and enhancing biodiversity, wildlife and environment.
2. Union of Cyprus Municipalities. Powers and duties of local authorities, technical know-how, recycling (e.g. "pay as you throw" systems). A long-awaited reform of municipalities, if implemented, should in theory increase the effectiveness of municipalities in meeting climate change goals.
3. Cyprus Energy Regulatory Authority. Renewable energy sources: solar, thermal, renewable fuels, smart grids, energy connectivity infrastructure, energy communities, clean energy package, and biomass energy.
4. Water Development Department. Desalination plants, research, waste and water management.
5. Deputy Ministry of Tourism. Existing hotels and their energy consumption; efficient cooling and heating systems; horizontal matters such as transport, use of electrical and hybrid vehicles, bike lanes, smart traffic lights; sustainable urbanization; and energy efficiency in buildings.

The new recovery plan will mark an acceleration of reforms that were under way as part of the Horizon 2020 programme. A key objective of Horizon 2020 was to reach a target of 3% of GDP for research and development spending across the EU by 2020. Cyprus only reached 0.5% of GDP but did launch a number of initiatives. For example, under the "circular economy" concept, research and development has been supported through universities, institutes, entrepreneurship centres and centres of excellence through programmes such as Restart 2016-2020 and Horizon 2020, which aim to build an economy based on knowledge and innovation. Cyprus has so far secured €129m in EU contributions by participating in 435 projects.

In October 2018 the Council of Ministers also committed €150m for future centres of excellence and the National Energy and Climate Fund (NECF) was set up. The Cyprus branch of Climate-KIC, the "European knowledge and innovation community" has also been active.



THE ROLE OF SOCIAL ACTORS

While Cyprus does not have a formal social contract as such, it has a long tradition of tripartite social dialogue. This comprises the government (mainly via the Ministry of Labour, Welfare and Social Insurance), the trade unions, the Employers' and Industrialists' Federation (OEB) and the Chamber of Commerce and Industry (KEBE). All these constitute the Labour Advisory Body, whose role was enhanced after the 2013 banking crisis and bailout programme.

The social partners submitted proposals for the recovery plan in early October 2020 and negotiations with the Ministry of Finance began on 3 November 2020. Ultimately, however, it is the Ministry of Finance which takes the decisions after consultations. At the same time, however, since the government has a minority in parliament, it will need broad support to implement legislation.

Given the fairly detailed RFF guidelines from the EU, there is broad consensus among the social partners on the major pillars. For example, the Cyprus Workers' Confederation (SEK) has made specific proposals on: the green and circular economy; green tax; digitalization and digital efficiency; social and civil protection; training; teleworking; e-governance; increasing labour productivity; and the redesign of public private partnerships. (Other unions' proposals are not yet known.) Trade unions are also expanding their cooperation with the Cyprus universities in the area of social policy design, training, and social protection.

OEB has proposed financial allocations for six of the Axes, with the bulk going to "green transition" and improving the business environment.

Prior to the approval of the Recovery and Resilience Facility, the government had made budgetary interventions of around €1.3 billion (around 6% of GDP). Interventions directly target at employers and employees amounted to €435 million, (including one-off small business support for operating expenses). Programmes implemented between March and June have supported more than two-thirds of workers (salaried employees and the self-employed) and just under two-thirds of employers.

Table 5
Cyprus: approved Covid-19 support plans, March-June 2020

	Number approved	% of total	Total in economy
Employers	26,905	64.5	41,690
Self-employed	23,055	58.1	39,690
Employees (private sector)	188,953	70.6	267,625

Source: Source: Ministry of Labour, Welfare and Social Insurance, Cyprus.

The initial support included the state paying up to 60% of insurable salaries for employees of companies that had been forced fully or partly to suspend operations, a similar scheme for the self-employed, support for special parental leave and for employees of businesses that had suffered a drop of more than 25% in turnover.

The following were additional measures to support businesses:

- Reduced special rate of value-added tax (VAT) from 9% to 5% for tourist accommodation and restaurants between 1 July 2020 and 10 January 2021.
- Postponement from April to July of the increases in contributions to the new National Health System (GESY).
- 3-month period deferral from May 2020 to end of July 2020 of social security contributions of the first trimester of the year, for self-employed persons.
- Tax credit for voluntary rent reduction. The income tax law was amended to grant a tax credit equivalent to 50% of rent reductions of between 30% and 50%.
- Temporary suspension of VAT payments. All suspended obligations are due to be paid by 10 November 2020.

Vocational training programmes have been established, focusing on the hotel sector, the rehabilitation of prisoners, and those aged 15 to 29.

Special employee training plans will start from November 2020 with the aim of helping 1,000 SMEs that have been affected by the pandemic.

In addition to the above, the Ministry of Labour has started dialogue with social partners for the continuation or amendment of the “special plan” programmes from November 2020 to March 2021. The special plans applied to the full and partial suspension of business operations among hotel units and tourism-related businesses as well as to certain economic activities that continue to be affected by the pandemic.

EVALUATION

As of early October 2020, the short-term goals of the Cyprus government have been broadly successful at the *aggregate* level. Employment growth is normally fairly closely correlated with real GDP growth, but the job-support programmes have so far limited the rate of decline of employment to much less than that of GDP. This was possible due to a previous history of fiscal consolidation: primary surpluses meant that the government had significant fiscal space to increase expenditure rapidly without destabilising public finances. The banking sector also entered the Covid-19 crisis much better capitalised and considerably more liquid than in the local banking crisis in 2013, although there are concerns that non-performing loans (NPLs) will rise sharply when the loan-suspension programme comes to an end at the end of December 2020. Government forecasts for the contraction in real GDP in 2020 have also been revised down, from 7.5% in July-August to 5.5% in September.

Nevertheless, Labour Force Survey data suggest that the pandemic has led to a sharp increase in young women leaving the labour force altogether – and not in order to enter education. It should be noted that our assessment about young female inactives is inferred from other data because there is no disaggregation. We therefore recommend that

Labour Force Surveys across the EU publish the number of “inactives” by age and not only by gender. For similar reasons, we recommend more frequent updates of data on the population at risk of poverty. Currently these are produced once per year, therefore it is impossible to make real-time assessments of the impact of external shocks on the most vulnerable populations.

The pandemic, which followed the establishment in February 2020 of a Deputy Ministry for Research, Innovation and Digital Policy headed by a former IBM executive, has resulted in a long overdue acceleration of digitisation, both in the public sector and the banks. For example, within just a few weeks of the lockdown, the government rolled out online applications and payments for income support. The Deputy Minister, Kyriakos Kokkinos, said in May that 160 e-government services were in the pipeline. The long overdue e-signature – an authorised coded series of numbers and characters – began to be rolled out in May and a programme to introduce e-justice was launched in October. The government has also pledged to tackle lack of STEM education and lack of digital support in schools. In the banking sector, Bank of Cyprus, which is the largest bank with 40% of the loan market, reported that 72% of customers were digitally engaged in the first half of 2020, compared with 62% in the same period of 2019.

Since EU membership in 2004, the contribution of the public sector (including defence but excluding health and education) to GDP had fallen from 11.2% in 2004 to 8.9% in 2019. As in many countries, the pandemic has significantly increased the role of the state in supporting incomes. Whether the state will be able to continue doing this will depend on many factors, in particular global interest rate levels and EU tolerance for budget deficits.

The biggest opportunity for ecological transformation comes from the EU’s Recovery and Resilience Facility. Cyprus is expecting €1.09 billion (around 5.3% of GDP), of which €978m has been allocated as grants. In a sign of greater EU fiscal coordination that some have heralded as the beginning of a fiscal union, the support is conditional on a range of reforms to speed up digitisation and the “greening” of the economy. Many of the reforms include those, such as justice and public-sector reform, that the minority government in Cyprus has been trying to pass for years. However, with the EU now using “carrots” rather than “sticks”, there is a greater chance that these long overdue transformations will be implemented.

Abbreviations

CAD/CAM	computer-aided design/manufacturing
CO₂	carbon dioxide
ETS	Emissions Trading System
EU	European Union
GDP	Gross domestic product
HRDA	Human Resources Development Authority
IMF	International Monetary Fund
INECP	Integrated National Energy and Climate Plan
KEVE	Cyprus Chamber of Commerce and Industry
Kgoe	kilograms of oil equivalent
KPIs	key performance indicators
LFS	Labour Force Survey
LNG	liquefied natural gas
MwH	Megawatt hours
NECF	National Energy and Climate Fund
NO_x	Nitrogen oxide
NPLs	non-performing loans
OEB	Employers' and Industrialists' Association
PCR	polymerase chain reaction
PM2.5	particulate matter of 2.5 micrometers or less
PPS	Purchasing Power Standard
RFF	Recovery and Resilience Facility
SEK	Cyprus Workers' Confederation
SMEs	small and medium-sized enterprises
STEM	science, technology, engineering, and mathematics
UK	United Kingdom
VAT	value-added tax
SO₂	sulphur dioxide

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- support for talented young people;
- maintaining the collective memory of social democracy with archives, libraries and more.

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Recovery strategies in Europe

The restrictions imposed to combat the COVID-19 pandemic have led to a pronounced drop in production, a steep rise in unemployment and public debt. As a result, profound social distortions have arisen. Further, the pandemic has also revealed the strong dependence of Europe's economy from the production of vital products beyond the continent. Accordingly, national governments as the EU have had to devise wide-ranging programmes to support and revive the economy.

The development of these "recovery" programmes is taking place at a point in time when the European economies are at a crossroads. They are faced with meeting the immediate challenges stemming from social and ecological transformation and digitalization. As a result, there is significant pressure to ensure that the measures to implement economic revival do not lead to a restructure of the pre-pandemic status quo. Instead, the countries should seize the opportunity of massive public spending programmes to start the transformation of the economy and society towards climate neutrality and social equality.

A series of reports from several European countries analyse their respective national recovery plans and assess them in view of meeting the complex challenges. A synopsis offers a comparative perspective by interpreting and classifying the events and individual measures introduced in the individual countries. The aim is to develop policy recommendations that not only meet the long-term structural challenges faced by the EU-member states, but also to combat the immediate effects of the pandemic.