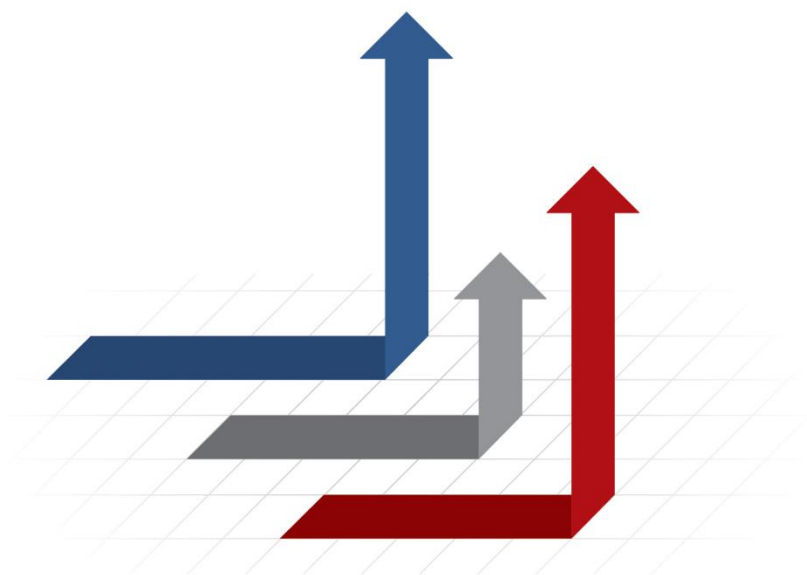




MINISTRY OF FINANCE

CYPRUS

MEDIUM-TERM FISCAL- STRUCTURAL PLAN FOR THE PERIOD 2025-2028



OCTOBER 2024

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1. INTRODUCTION

Regulation (EU) 2024/1263 (the “Regulation”) on the effective coordination of economic policies and on multilateral budgetary surveillance repealing Council Regulation (EC) No 1466/97, entered into force on 30 April 2024, with the aim to promote fiscal sustainability and sustainable and inclusive growth.

The Republic of Cyprus hereby submits its Medium Term Fiscal Structural Plan (“MTFSP” or the “Plan”) for the period 2025-2028, in accordance with Articles 11 and Article 36.1(a) of the Regulation. Based on the transitional provisions, as foreseen in Article 36.1(a) of the Regulation, Cypriot Authorities requested by letter to the European Commission on 04 September 2024 the extension of the deadline for the submission of its Plan until 15 October, given the time necessary to prepare the fiscal and macroeconomic forecasts and conclude the national procedures. The European Commission, with a letter on 24 September 2024, transmitted its agreement in extending the deadline.

The Plan has been prepared in line with the Guidance transmitted to Member States by the European Commission on 20 June 2024, which sets out the information requirements and takes into account the reference trajectory provided by the European Commission on the same date. The analysis and forecasts contained in this document are based on data available until 06 September 2024. The macroeconomic forecasts contained herein have been endorsed by the Fiscal Council. The opinion of the Fiscal Council in the context of the 2025 budgetary process is presented in Annex 2, according to the European Commission’s guidelines.

The Plan was approved by the Council of Ministers on 9th October 2024, according to the relevant national legislation. Given the provisions of Article 36.1(c) of the Regulation and the tighter schedule envisaged for the preparation of the first Plan, a consultation of social partners, regional authorities, civil society organisations and others was not conducted. However, significant number of structural reforms and investments included in the Plan are also included in Cyprus’ Recovery and Resilience Plan, and therefore had already undergone consultation with the social partners and civil society.

The rest of the document is organized as follows. Section 2 gives an overview of the fiscal commitment. Section 3 presents the macroeconomic forecasts, while Section 4 describes the fiscal and budgetary forecasts and Section 5 provide information on contingent liabilities. The Debt Sustainability Analysis is presented in Section 6. Finally, Section 7 gives an overview of the major structural reforms and investments Cyprus is planning to implement in the four-year period, in response to the country-specific recommendations (CSRs) (including under the Macroeconomic Imbalance Procedure) and EU common priorities.

2. OVERVIEW OF THE FISCAL COMMITMENT

In accordance with Article 13 of the Regulation and to demonstrate compliance with the fiscal requirements of Article 16(2) and (3) of the Regulation, the Plan follows a risk-based approach to identify an expenditure path that will enable the sustainable and growth-friendly reduction of debt. Cyprus opts for a four-year plan without extension of the adjustment period that sets the average annual net expenditure growth rate at 4.9% during the period and expected to result in a debt ratio of 47.4% in 2028. The debt and budget balance levels comply with the Debt Sustainability Safeguard and Deficit Resilience Safeguard, as described in Article 7 and 8 of the Regulation during the Plan's horizon. Moreover, by the end of the Plan, Cyprus is expected to comply with the Article 6, 7 and 8 of the Regulation, i.e. assuming that there are no further budgetary measures the projected debt ratio will remain on a plausibly downward path and below the 60% of GDP reference value over the medium-term and the projected general government budget balance is maintained below the -3% of GDP over the medium-term.

Table 1: Main variables					
	2024	2025	2026	2027	2028
Real GDP growth (%)	3.7	3.1	3.2	3.3	3.0
Net nationally financed primary expenditure (annual Δ %)	7.0	5.9	5.0	4.5	4.3
Net lending/borrowing (% of GDP)	3.9	2.7	2.6	2.1	2.1
Structural balance (% of GDP)	2.7	1.8	1.6	1.1	1.2
Structural primary balance (% of GDP)	4.2	3.3	3.1	2.5	2.4
Gross debt (% of GDP)	68.9	64.1	58.8	53.3	47.4
Change in gross debt (% of GDP)	-8.5	-4.8	-5.3	-5.6	-5.9

3. MACROECONOMIC DEVELOPMENTS AND PROJECTIONS

3.1 GDP GROWTH

The Cypriot economy continues to record remarkable growth, demonstrating resilience and dynamism in a challenging global environment. Following the increase of real output by 5.1% in 2022, the economy in **2023** recorded a slowdown with a rate of increase of 2.5%. The 2023 growth, was driven mainly by the increase in domestic demand, especially by private consumption and by a lesser extent, of investments. On the other hand, net exports contributed negatively. This was mainly due to the decrease in exports of financial services (due to the sanctions imposed against Russia), which outweighed the continued improvement of the tourism sector and thus the expansion of tourism revenues, and as well due to the increase in imports of goods for home consumption and investment.

From a sectoral point of view, GDP developments in 2023 were also reflected at the level of economic sectors, where growth was positive and widespread with negative contribution only in sectors “Financial and insurance activities” and “Professional, scientific and technical activities”.

For **2024 so far**, real output (based on seasonally and working day adjusted data) increased by 3.5% in the first half of 2024, compared to the first half of 2023. This high rate of growth demonstrates the gradual smoothing of the economic impact of the ongoing sanctions against Russia, that had an impact in the slowdown in 2023 and the limited impact on the economy from conflicts in the Middle East.

From the expenditure side, in the first half of 2024 compared with the first half of 2023, growth was mainly driven by export of services. From a sectoral point of view, value added increased in almost all sectors but it was most pronounced in the following four sectors: “trade, transportation and storage, accommodation and food service activities”, “information and communication”, “construction”, “public administration, education and health” and “professional and administrative services”.

For 2024 as a whole, GDP is expected to increase by 3.7%. GDP is expected to grow at faster pace compared with our previous projections as included in the Stability Programme 2024-27 forecasts (2.9% for 2024) and European Commission’s 2024 Spring Forecast (2.8% for 2024) due to the momentum from the better-than-expected economic results of the first half of 2024 in relation to the performance of sectors such as trade, services related to tourism, technology and construction.

In the medium-term period 2025-2028, growth is forecast to remain robust. Real GDP growth is forecast at 3.1% in 2025, 3.2% in 2026, 3.3% in 2027 and 3.0% in 2028. The projected GDP growth in the years 2024-2028 is mainly due to the expected further rise in domestic demand as well as the recovery of the external demand.

A high degree of uncertainty is surrounding this year’s forecasting profile again due to the ongoing war between Russia and Ukraine, the US/UK sanctions but also due to the conflict in the Middle East.

From a sectoral perspective, growth is expected to be broad based and it is not expected to denote any negative growth in any sector. The sectors that are expected to contribute the most to growth over the period 2024-2028 include mainly those related to trade and tourist activities. Other growth drivers, but to a lesser extent, include information and communication activities, the construction sector and lastly by the manufacturing sector as well.

3.2 INFLATION

Inflation, as measured by the Harmonized Index of Consumer Prices (HICP), decreased significantly and averaged at 3.9% in **2023** compared to a rate of 8.1% in 2022. Inflation was driven by lower international oil prices, with a significant impact on domestic prices of the energy products. For the period January-December 2023, compared to the corresponding period of the previous year, the largest changes were noted in Food and Non-Alcoholic Beverages (8.0%) and Restaurants and Hotels (6.4%). The HICP, excluding energy and unprocessed food, in 2023 was 4.4%.

For the first eight months of 2024, the HICP rose by 2.3% compared to the corresponding period in 2023. For the period January-August 2024, compared to the corresponding period of the previous year, the largest change was noted in Restaurants and Hotels (5.6%). The HICP, excluding energy and unprocessed food, in January-August 2024 was 2.4%. Inflation's downward trend in the aforementioned period is mainly due to the ECB's monetary policy, of which the impact still has a suppressive effect with a time lag combined with energy and industrial products excluding energy price developments as well as the Government's relief measures for the high energy prices.

Inflation, is estimated to decrease further compared with 2023, to 2.2% in 2024 and then hover around the medium-term target of 2.0% in the years 2025-2028. The further decline of inflation is expected to occur due to the projected continuous and complete weakening of the inflationary pressures created in previous years by exogenous factors on the part of supply as well as due to the impact of the single monetary policy which continues to have a repressive effect in the short-term horizon but also with a time lag in the medium-term horizon. Additionally, the expected normalization both in business profit margins and in wage increases as well as the projected slowdown in non-industrial product prices excluding energy are factors that are also expected to contribute to the slowdown in the HICP over the period 2024-2028.

GDP deflator is projected to increase above inflation in 2024 and 2025 and in the period 2026-2028 to evolve in line with inflation at around 2%. Thus, nominal GDP will increase by around 7% in 2024 and then will hover around 5.3% in 2025-2028.

Oil Prices and interest rate assumptions used in the macroeconomic projections for inflation are presented in Table A3 (Annex 1).

3.3 LABOUR MARKET

Regarding the **labour market**, it remains resilient despite of the effects of the war between Russia and Ukraine and also the conflicts and geopolitical tension in the Middle East.

Recovery in employment continues in **2023**, albeit at a slower pace. Employment in persons increased with an annual growth rate of 1.5% in 2023, compared with 3.0% in 2022. In hours worked terms, employment increased with an annual growth rate of 1.7% in 2023, compared with 4.1% in 2022.

In the **first half of 2024**, employment in persons increased with an annual growth rate of 2.1% in the first half of 2023 and in hour worked terms, employment increased with an annual growth rate of 2.5% respectively. The most significant increases in number of persons were observed in the economic activities of "Education",

“Public Administration”, “Wholesale and retail trade”, “Accommodation and food service activities”, “Administrative and support service activities”, “Manufacturing” and “Construction”.

In line with the positive trajectory of GDP, a rise in employment of around 2% is expected in 2024 and a further increase of 1.5-2.0% annually in the years 2025-2028.

The unemployment rate in 2023, as measured by the Labour Force Survey (LFS), averaged at 5.8%, recording a decrease of around 0.6 percentage points compared to the average of 2022 (6.2% in 2022). It's worth mentioning that the rate of 5.8% in 2023 was the lowest level in the last fourteen years (5.4% in 2009). The composition of unemployment indicates that youth and long-term unemployment still remain the major challenges of the labour market, but recording significant de-escalation since. Youth unemployment peaked in the 2nd quarter of 2013 reaching a rate of 40.3% of the labour force and pursued a downward path since then. In 2023 it averaged at 16.6%, compared to 18.1% in 2022. A significant parameter in the labour market analysis is the stabilization of long-term unemployment at low levels, remaining at 1.5% in the fourth quarter of 2023, after peaking at 7.7% in 2014 and then follow a declining path, reflecting stability in the labour market.

In the first half of 2024, the unemployment rate in averaged at 5.2%, recording a decrease of 1.0 percentage point compared to the average of the first half of 2023 (6.2%). In specific, the unemployment rate recorded in the second quarter of 2024 was 4.6%, compared with 5.7% in the second quarter of 2023, thus indicating the labour market is operating in full employment as also seen by the high vacancies ratio and the strong employment growth. In the same period, youth unemployment reduced to 15.1% from 15.7% and long-term unemployment to 1.6% from 2.1% in the 1st half of 2024 compared with the first half of 2023.

Unemployment is expected to continue its downward trend, reaching 5.0% of the labour force in 2024, from 5.8% in 2023. In the coming years, it is projected to approach full employment conditions, reaching 4.8% in 2026, 4.6% in 2027 and 4.5% in 2028. The downward revision in the unemployment rate in 2024 of 0.8 percentage point from the March forecast of 5.8% reflects the better outcome of the first half of the year (5.2% in 2024H1 from 6.2% in 2023H1) and the revision of the historical data based on the new census results.

3.4 CURRENT ACCOUNT

According to the preliminary **Balance of Payments** data for 2023, the Current Account (CA) deficit widened to €3,607.2 million (-12.1% of GDP) compared with a deficit of €2,202.7 million (-7.9% of GDP) in 2022. The worsening of the CA deficit derives mainly from the deficits in the goods balance and the primary income account, while the services balance surplus partially offset the result.

The deterioration in primary income account in recent years is related to the expansion of services exports (especially ICT-related exports) due to the profits of the foreign companies that have established on the island which are accounted for as outflows.

Adjusted for the impact of SPEs, that is, classifying SPEs as non-residents, the CA deficit in 2023 also recorded a deterioration by €3,434.2 million (-11.5% of GDP) compared with €2,540.9 million (-9.1% of GDP) in 2022.

In the first quarter of 2024, the **current account** recorded an improvement, with the deficit decreasing from €1,881.7 million (-6.3% of GDP) in the first quarter of 2023, to €890.2 million (-2.8% of GDP), in the first quarter of 2024. The decrease in the CA deficit resulted mainly from the improvements of the deficit of Goods and the

surplus of Services. In particular, the decrease in the deficit of Goods, the increase in the surplus in Services and to a lesser extent - the decrease in the deficit of Secondary Income, contributed to the shrinkage of the deficit. The aforementioned developments were partly offset by the deterioration of the deficit of Primary Income.

The resulting **deficit adjusted for the impact of Special Purpose Entities (SPEs)**, that is, classifying SPEs as non-residents, stood at €1,007.1 million (-3.2% of GDP) in Q1 2024, compared with a deficit of €1,234.5 million (-4.1% of GDP) in Q1 2023.

Over the medium-term, the deficit is expected to gradually improve, but remain though at relatively high levels, as long as the goods and services balances are expected to improve, and thus, the trade balance, which is expected to gradually improve too. The income balance is also expected to gradually improve over time as mentioned above.

Although the current account balance will decrease over time, it will still remain well above the threshold set by the European Commission of -4/+6%.

3.5 POTENTIAL GROWTH AND OUTPUT GAP

For the calculations of the potential growth and the output gap, the Potential Output Gap Working Group (POWGW) commonly agreed methodology was used with the Ministry's macroeconomic assumptions for the years 2024-2028. According to the results, the major contributor to potential is capital accumulation followed by labour contribution.

Recently implemented structural reforms are considered in the potential growth projections in a prudent manner. The impact is expected to be more gradual and not in the short term. Additionally, in potential growth calculations, only implemented reforms and investments are taken into account, as included in the projected path of gross fixed capital formation in the baseline scenario. The expected impact on economic activity of not-yet-implemented reforms and investments are not be taken into account in the potential GDP estimates. All not implemented investments consist an upside risk since the baseline follows a conservative approach.

Table 2: Main macroeconomic variables					
	2024	2025	2026	2027	2028
Real GDP growth (%)	3.7	3.1	3.2	3.3	3.0
GDP Deflator (%)	3.8	2.4	2.0	2.0	2.0
Nominal GDP growth (%)	7.5	5.6	5.3	5.3	5.0
Potential GDP growth (%)	3.9	3.6	3.3	3.3	3.1
Output gap (%)	2.4	1.9	1.9	1.8	1.7

3.6 EXTERNAL ASSUMPTIONS

The external assumptions that underpin the macroeconomic and budgetary projections presented in previous sections are presented in Table A3 (Annex 1).

The exchange rate (USD / euro) is expected to decrease to 1.07 in 2024-2025 compared with 1.08 on average in 2023. Oil prices (measured in Brent, USD/barrel) are expected to increase in 2024 to \$85.4 per barrel and then decrease to \$80.0 per barrel in 2025. Oil prices assumptions are reflected in inflation, imports and imports deflator projections.

short term interest rates are expected to peak in 2024 and then reduce in 2025 following the expected ECB interest rate path for 2024-2025. Long term interest rates, are expected to marginally increased in 2025. Interest rates assumptions are as used in the projections of consumption and investment paths.

Regarding the EU growth, the assumptions are for a low growth in real GDP in 2024 and a further improvement in 2025 as reflected in the exports projections since the EU is a significant trading partner.

3.7 DEVIATIONS

The macroeconomic forecast of the Ministry of Finance deviates from the Spring Forecasts used by the Commission in the calculation of the Reference Trajectory. Main differences concern the forecasts for the GDP growth and the potential GDP growth rates of the economy, which have implications on the projected output gap during the duration of the plan (2025-2028). More specifically:

- Regarding the years 2024-2025, the Commission's forecasts were in line with the Ministry's forecast in April 2024 for the Stability Programme 2024-2027 (2.9% for 2024 and 3.1% for 2025). At that time (March-April 2024), no data on GDP were available and other indicators were limited. Commission's Spring Forecasts (SF24), which were used in the preparation of the reference trajectory, published in mid-May 2024 were 2.8% for 2024 and 2.9% for 2025 (difference 0.1 and 0.2 respectively). The Ministry's forecasting used for the preparation of the Plan were prepared in early September 2024 for the 2025 Budgetary process, with a cut-off date of 06 September 2024. At this date, the official GDP data for the first half of 2024 were available, pointing out a growth of 3.5% compared to the equivalent first half of 2023. Other soft data available at that date, also point to a good performance. Thus, the Ministry has revised its forecast for 2024 by around 0.9 p.p. from 2.9% to 3.7% due to the better-than expected performance, while maintaining its forecast for 2025, at 3.1% since no new indications were available for 2025 to justify a revision for this year. It should be noted that the 3.1% forecast was also used in DBP 2024 based on the same economic arguments. To sum up, the main reason for the deviation in 2024-2025 is: (i) the timing of the forecasting round and (ii) the available information. If the Commission runs the output gap calculation taking into account the official data, the output gap would have been smaller. The deviation in the 2024 growth rates (3.7% vs 2.8%) also causes a level effect on the potential growth in euros carried out, thus making the gap more difficult to close by 2028, unless growth rates become too low which we consider as a highly unlikely scenario.
- Regarding the years 2026-2028, the Commission uses the closure rule, a mechanical rule that drives/forces the gap to close by 2028. Components in the mechanical rule, such as employment, become almost zero or even negative and thus potential growth in these years is solely driven by TFP and Capital. The implied real GDP growth to close the output gap by 2028, will be very low and "unrealistic", which is rather

conservative for this horizon. The labour market in Cyprus has proved resilient, which is in contrast with the above. For a longer time horizons, for instance from 2030 onwards these contributions seem more realistic to be used as a conservative scenario and for the output gap to close. The MOF estimates that real GDP will hover around its potential growth of 1.5%-1.8% in the long term, and therefore similar provisions have been used in the Stability Programme 2024-2027.

It should also be noted that, potential output projections make use of the Ageing Report 2024, which were published in 2023 using data with 2022 as cutoff data. Data for Cyprus were revised afterwards, so the report uses older historical data, which have an effect on forecasted potential figures. Furthermore, the anticipated revisions of historical GDP of a great magnitude are expected to also make the output gap projections more favourable compared to Ageing Report 2024.

Table 3: Deviations from Commission's Spring forecasts					
	2024	2025	2026	2027	2028
Real GDP growth (%)					
- CY authorities' forecasts	3.7	3.1	3.2	3.3	3.0
- Commission's Spring forecasts	2,8	3,0	2,2	1,5	1,6
Potential GDP growth (%)					
- CY authorities' forecasts	3.9	3.6	3.3	3.3	3.1
- Commission's Spring forecasts	3,7	3,5	2,6	2,0	1,8
Output gap (%)					
- CY authorities' forecasts	2.4	1.9	1.9	1.8	1.7
- Commission's Spring forecasts	1,6	1,1	0,7	0,2	0,0

4. FISCAL DEVELOPMENTS AND PROJECTIONS

4.1 POLICY STRATEGY

The overall objective of the fiscal policy strategy is to support economic growth, while maintaining fiscal sustainability through a sound fiscal position in the medium term and reducing public debt as a percentage of GDP in a sustainable manner. The focus of the government strategy is driven by the implementation of the Reforms and Investments presented in Chapter 7, which encompass the main national policies for sustainable growth and competitiveness enhancement.

In 2023 the fiscal position improved further, despite the expansionary impact of the Energy-related measures of about -0.6% of GDP on the accounts of the general government, with the budget balance reaching a surplus of 3.3% of GDP compared to the surplus during 2022 of 2.7% of GDP. At the same time, the significant public surpluses presented during the recent years, both in nominal and in structural terms, the normalisation of inflation and in general, the favourable economic situation with the employment and GDP growing steadily, have set the conditions for the decrease of public debt, by 8.3 percentage points of GDP, falling to 77.4% in 2023 from 85.7% in 2022, below its pre-Adjustment Programme levels.

4.2 DEVELOPMENTS 2023

In 2023, the general government budget balance improved significantly, from a surplus of 2.7% of GDP in 2022 to a surplus of 3.3% of GDP. The improvement in the fiscal position by 0.6 pp. of GDP during the year under review is mainly attributed to the increases, which were recorded in most revenue categories, reflecting the continuous improvements in the economy. In nominal terms, the budget balance of the general government reached €993 million in 2023 compared to €758 million the year before. Primary balance increased to €1,400 million (4.7% of GDP) in 2023 from €1,166 million in 2022 (4.2% of GDP).

In structural terms the budget balance reached 2% of GDP recording an improvement of 1.4 percentage points of GDP from 0.6% in 2022. Structural primary balance improved by 1.3 percentage points of GDP reaching 3.4% in 2023 from 2.1% of GDP in 2022.

Revenue, 2023

In 2023, total revenue as a percentage of GDP recorded an increase of 2 percentage points from 41.5% in 2022 to 43.5%. In value terms, total revenue increased significantly by 12.4% compared to 2022, from €11,539.8 million in 2022 to €12,972.6 million in 2023, with almost all revenue categories recording an increase compared to the year before.

Tax revenue increased by 10.8% during 2023, from €6,958.2 million (25.1% of GDP) in 2022 to €7,706.9 million (25.9% of GDP). Receipts from taxes on production and imports had the highest contribution to the growth of tax revenue, of about 5.9 percentage points, which recorded an increase of 10.1% in value terms, from €4,033.5 million in 2022 to €4,442 million in 2023, benefited from high inflation rates and increased consumption.

Revenue from taxes on income and wealth increased by 11.7%, from €2,924.2 million in 2022 to €3,264.9 million in 2023, reflecting the further improved performance of businesses, the sustained employment growth, as well to the collections of the Tax Department related to a scheme for the clearance of the past tax

arrears. As a percentage of GDP, current taxes on income and wealth increased by 0.5 percentage points during 2023, from 10.5% in 2022 to 11%.

Revenue from social security contributions increased by 15% during 2023, from €3,122 million in 2022 to €3,590.2 million, contributing the most to the increase of public revenue by 4.1 pp. attributed to the improved labour market conditions and consequently to the increased contributions in the context of the Social Security Fund (SSF) and the General Healthcare System (GHS). As a percent of GDP, revenue from social security contributions increased from 11.2% in 2022 to 12% in 2023.

Property income as a percent of GDP increased to 0.5% in 2023 from 0.4% in 2022, and finally, category 'other revenue' reached 5.2% from 4.8% of GDP in 2022, reflecting the continued pick-up in the rate of absorption from the EU's Structural and Cohesion Funds.

Expenditure, 2023

Total expenditure in 2023 as a percentage of GDP, exhibited an increase of 1.4 percentage points, from 38.8% of GDP in 2022 to 40.2% of GDP in 2023. In value terms, public expenditure increased by 11.1%, from €10,781.8 million in 2022 to €11,980.1 million in 2023.

Compensation of employees increased significantly by 13%, from €3,179.2 million in 2022 to €3,591.8 million in 2023, contributing the most to the growth of public expenditure by 3.8 percentage points. This was mainly the outcome of the increased COLA adjustment (contribution +5.3 pp.) taking into account (i) the high inflation rate during 2022 and (ii) the increased inflation incorporation to the index for COLA calculation purposes, from 50% to 66.7% as of 1st June 2023, the termination of the wage cuts as of 1st January 2023 (+2.3 pp.), the increased expenditure for pensions and gratuities (+1.8 pp.), the contribution of the government as an employer to the New Pension Scheme¹ (+0.7 pp.) and increments (approximately +1 pp.). As a percentage to GDP, compensation of employees recorded an increase of 0.7 percentage points, from 11.4% in 2022 to 12.1% of GDP in 2023.

Intermediate consumption recorded growth rate of 4.9%, reaching €1,301.2 million in 2023 from €1,240.6 million in 2022, whereas as a percentage of GDP recorded a decrease of 0.1 percentage points, falling to 4.4% in 2023 from 4.5% the year before.

Social payments increased at a rate of 7.2% during 2023, reaching €4,513.9 million from €4,211.7 million in 2022, contributing significantly to the growth of public expenditure by 2.8 percentage points. This outcome was attributed both to the increased expenditure in the context of the GHS as well as to the expenditure for old-age pensions (contribution 3.5 pp. and 1.9 pp., respectively). As a percentage of GDP, social payments declined marginally by 0.1 percentage point, falling to 15.1% from 15.2% in the year before.

Expenditure category subsidies recorded an increase of 15.9%, from €139.3 million in 2022 to €161.4 million in 2023, mainly due to the subsidisation of the electricity bills of consumers, in the context of the package of the Energy related measures. As a percentage of GDP, subsidies remained at 0.5% as in the year before.

¹ Civil Servants Pension Scheme is based on a Law of 2022 which Benefits Civil Service Employees and the broader Public Sector (including Municipalities and Community Boards) and it is in force since 1/1/2023. Members of the Scheme are employees (permanent or indefinite time) serving since 10/2011.

Interest expenditure reached €407 million in 2023 from €407.8 million in 2022, recording a marginal decrease of 0.2%. As a percentage of GDP, interest expenditure declined marginally from 1.5% in 2022 to 1.4% of GDP in 2023.

Gross fixed capital formation recorded a significant increase of 38% during 2023 reaching €984.5 million from €713.3 million in 2022, mainly due to increased expenditure for the purchase of a new building, for the construction maintenance of roads and for defense purposes. It is noted that 2.1 percentage points of this increase relates to expenditure under the RRP. As a percent of GDP this expenditure category increased to 3.3% from 2.6% in the year before.

Finally, category 'other expenditure' recorded an increase of 14.7% in 2023, from €889.9 million in 2022 to €1,020.3 million in 2023, increasing as a percentage of GDP at 3.4% from 3.2% the year before.

Public debt, 2023

At the end of 2023, the debt-to-GDP ratio fell at 77.4% of GDP, recording a cumulative decline of 37.7 percentage points since 2020. This significant reduction was both attributed to the utilization of a significant amount of cash reserves to cover a part of gross financing needs and to the increase of the nominal GDP. In nominal terms, public debt fell at €23,075.8 million end-2023 from €23,813.3 million end-2022.

4.3 DEVELOPMENTS 2024

According to the most recently available data for current year, general government budget balance during the period January-July 2024 recorded a significant increase as a percent of GDP of 1 percentage point, reaching 2.2% from 1.2% of GDP during the same period in 2023. In nominal terms, general government budget balance reached €702.4 million from €345.8 million during January-July 2023, driven by the significant increase of public revenue, which overpassed the increase of public expenditure that was recorded during the period under review. Primary balance was in surplus of about €982 million (3.1% of GDP), compared to a primary balance of €597.5 million (2% of GDP) during January-July 2023.

Revenue, January-July 2024

Public revenue recorded a significant y-o-y increase of 14.2% during January-July 2024, reaching €7,662.1 million from €6,709 million during January-July 2023, with revenue from social contributions contributing the most to this y-o-y percentage change (+4.9 pp.). As a percent of GDP public revenue during the period under review increased by 1.5 percentage points, from 22.5% during January-July 2023 to 23.9%.

More specifically, social security contributions reached €2,347.6 million from €2,019.7 million during January-July 2024 exhibiting an increase of 16.2%, driven mainly from the increase in the contribution rates in the context of the Social Security Fund as from 1st January 2024, from the increase in nominal earnings, as well as from the retroactive payments under the New Pension Scheme, which will cover the years before 2023 and that will take place during 2024-2026. As a percent of GDP social security contributions reached 7.3% from 6.8% during January-July 2023.

Tax revenue increased by 10.3% reaching €4,453.1 million in nominal terms from €4,038.9 million during the same period in 2023. As a percent of GDP tax revenue during the period under review increased by 0.3 percentage points reaching 13.9% from 13.6% of GDP in during January-July 2023, driven mainly from the

increase of revenue from current taxes from income and wealth, which contributed to the increase of tax revenue with 3.6 percentage points.

Current taxes from income and wealth recorded a rate of growth of 14.6%, from €1,630.8 million during January-July 2023 to €1,869.3 million during the period under review. This was mainly driven by increased receipts from corporate tax of the order of 24.5% (from €578.2 million to €719.9 million), as well as from the increased income tax receipts of employees by 12.4% (from €530.7 million to €596.4 million). As a percent of GDP this revenue category increased at 5.8% from 5.5% during January-July 2023.

Revenue from taxes on production and imports reached €2,583.8 million during January-July 2024 from €2,408.1 million in the same period of 2023, recording a rate of growth of 7.3%, remaining as a percent of GDP at 8.1%.

Property income increased by 34.5% during the period under review, reaching €81.9 million from €60.9 million during the same period in 2023, marginally increasing as a percent of GDP to 0.3% from 0.2%.

Finally, revenue under category 'other revenue' exhibited an increase of 32.2% during the period under review, from €589.5 million to €779.5 million and as a percent of GDP reached 2.4% from 2% during the same period in 2023.

Expenditure, January-July 2024

Public expenditure increased by 9.4% during January-July 2024, reaching €6,959.7 million from €6,363.2 million during January-July 2023, mainly attributed to the increases which were recorded for compensation of employees and for social payments. As a percent of GDP public expenditure increased by 0.4 percentage points, reaching 21.7% from 21.3%.

More specifically, expenditure for compensation of employees increased by 12.2% during the period under review, reaching €2,138 million from €1,905 million during the same period in 2023. This was mainly the outcome of (i) the increased COLA adjustment (+1.9 pp.), taking into account the high inflation rate during 2023 and the increased inflation incorporation to the index for COLA calculation purposes, from 50% to 66.7% as of 1st June 2023, (ii) the retroactive payments to the New Pension Scheme as of 1st January 2024 (+3.1 pp.), (iii) the increased contribution of the government as an employer in the context of the SSF (+0.9 pp.), (iv) the provision of increments (approximately +0.9 pp.), and (v) the increased expenditure for allowances and overtime payments (+0.6 pp.). As a percent of GDP expenditure for compensation of employees increased by 0.3 percentage points, reaching 6.7% from 6.4% during January-July 2023.

Expenditure under category social payments reached €2,772 million from €2,564 million in January-July 2023, recording a rate of growth of 8.1%, mainly due to the increased compensations of Health Insurance Organisation (HIO) to private health providers (+2.3 pp.), to the increased contribution of the government in the context of SSF (+1.8 pp.), as well as to the increased payments for old-age pensions (+2.8 pp.). As a percent of GDP social payments remained at 8.6% as in the same period in 2023.

Intermediate consumption increased by 17.8% during January-July 2024, reaching €723.1 million from €613.6 million during the same period in 2023, reaching 2.3% as a percent of GDP from 2.1%. The main driver of the increase under this expenditure category was the increased expenditure for the purchase of desalinated water, which contributed to this increase by 7.3 percentage points.

Interest expenditure reached €279.6 million during January-July 2024 from €251.7 million during the same period the year before, recording an increase of 11.1% and as a percentage of GDP it recorded an increase, from 0.8% in 2022 to 0.9% of GDP.

Expenditure category subsidies fell at €80.6 million during the period under review, from €99.7 million during the corresponding period in 2023, recording a negative rate of growth of 19.2%, mainly due to the decreased cost for the subsidisation of the electricity bills of consumers, in the context of the package of the Energy related measures. As a percentage of GDP, category subsidies remained at 0.3% as in the year before.

Gross fixed capital formation recorded a decrease of 17.4% during January-July 2024 falling to €352.3 million from €426.3 million during January-July 2023, mainly due to increased expenditure that took place in the corresponding period the year before.

Finally, category 'other expenditure' recorded an increase of 22.1% during January-July 2024 reaching €614.4 million from €503.1 million during January-July 2023, mainly due to the methodological treatment for the neutralization² of New Pensions Scheme's surplus (+16.9 pp.). As a percent of GDP, this expenditure category increased at 1.9% from 1.7% the year before.

Public debt, end-July 2024

Public debt continued its decreasing path falling to 71.4% end-July 2024 from 78.8% end-July 2023. In nominal terms, public debt dropped from €23,489.3 million to €22,896.2 million recording a decrease of about €0.6 billion.

4.4 BUDGET 2024

According to the most recently available data and taking into account the baseline macroeconomic scenario, the budget balance is expected to remain in surplus during 2024 reaching €1,261.4 million, driven mainly by the expected economic performance during the year, benefited also by the increase in the Social Security Fund's contribution rates as from 1st January 2024. As a percent of GDP, general government budget balance is forecast to reach 3.9% of GDP, recording an improvement of 0.6 percentage points compared to 2023. Primary balance is forest to reach €1,717.1 million, corresponding to 5.4% as a percent of GDP compared to 4.7% in the year before, while in structural terms primary balance is expected to reach 4.9% of GDP.

Taking into account the output gap estimations, which are derived from the commonly agreed methodology, the structural balance for 2024 is estimated to reach 2.7% from 2% of GDP in the year before, with structural primary balance reaching 4.2% in 2024 from 3.4% of GDP in 2023.

Revenue, Budget 2024

In accordance with the baseline macroeconomic scenario, total revenue during 2024 is anticipated to record a positive rate of growth of the order of 11.8% compared to 2023, reaching €14,498.4 million from €12,972.6 million in 2023, driven mainly by the expected increase from receipts from **social contributions** (+4.6 pp.) and from **taxes from income and wealth** (+3.5 pp.), as well as from the expected **increase of grants to be received**

² This methodology is under examination.

in the context of the RRF. As a percent of GDP, public revenue is forecast to increase by 1.7 percentage points, from 43.5% the year before to about 45.2% of GDP.

More specifically, tax revenue in 2024 is forecast to exhibit a significant growth rate of 10.1% and to reach €8,485.8 million compared to €7,706.9 million in 2023, mainly due to the expected increase in the receipts from **current taxes from income and wealth** (+6 pp.), taking into account the overperformance of this revenue category during the first seven months of 2024. As a percentage of GDP revenue from taxes is forecast to reach 26.5% from 25.9% in the year before.

Revenue from **social security contributions** is forecast to exhibit an increase of about 16.6% in 2024, driven mainly from the increase in the contribution rates in the context of the Social Security Fund as from 1st January 2024, as well as due to the expected increase in nominal earnings. As a percent of GDP, revenue from social security contributions is expected to increase by 1.1 percentage points in 2024, reaching 13.1% from 12% of GDP in 2023.

The growth in category “**other revenue**” is expected to reach 9.5% stemming mainly from the expected increase of grants to be received in the context of the RRF (+7.4 pp.). As a percent of GDP, category “other revenue” is expected to increase to 5.3% in 2024 from 5.2% in the year before.

Expenditure, Budget 2024

Public expenditure is expected to exhibit an increase of 10.5% and to reach 41.3% as a percent of GDP from 40.2% in 2023. In nominal terms public expenditure is forecast to reach €13,237 million from €11,980.1 million during 2023, mainly due to the expected increases that will be recorded under payments for **compensation of employees** and for **social payments** (+3.9 pp. and +3.1 pp., respectively).

In more detail, **compensation of employees** is forecast to exhibit a significant increase of 13.1% in 2024 compared to the year before and to reach €4,064 million from €3,591.8 million, contributing the most to the growth of public expenditure. This y-o-y increase is expected to be brought mainly by the retroactive payments paid by the government to the New Pensions Scheme, starting from 2024 until 2026, for public servants hired after 2011 (+3.6 pp.), to the provision of Cost-of-Living Adjustment (+3 pp.), to the increased contribution of the government as an employer in the context of the SSF (+0.9 pp.), as well as to the provision of annual increments (+1 pp.). As a percent of GDP, compensation of employees is forecast to reach 12.7% from 12.1%.

Social payments are forecast to marginally increase as a percent of GDP and to reach 15.2% from 15.1% in the year before, albeit increase in nominal terms by 8.2% reaching €4,882.4 million from €4,513.9 million 2023. This increase is mainly attributed to the expected increased payments for old-age pensions, higher expenditure of the HIO to public health providers, as well as to the increased SSF contribution of the government as a third party.

The growth rate of **net nationally financed primary expenditure** is forecast to reach about 7% compared to the year before.

Public debt, Budget 2024

Public debt is expected to decrease further by end-2024, falling at €22,088.8 million from €23,075.8 million end-2023. As a percent of GDP public debt is forecast to exhibit a decline of 8.5 percentage points of GDP and to drop below 70%, from 77.4% of GDP in 2023 to 68.9% of GDP by end 2024.

4.5 MEDIUM-TERM BUDGET BALANCE 2025-2028

During the medium-term period 2025-2028 the budget balance of the general government is forecast to remain positive and average at 2.4% of GDP, falling gradually from 2.7% of GDP in 2025 to 2.1% of GDP in 2028. Primary balance is estimate to average at 3.8% of GDP during the period under review, gradually falling to 3.3% of GDP in 2028 from 4.3% of GDP in 2025. The forecast positive outcome in the accounts of the general government during the medium term is attributed to the high revenue base levels in the years before, despite the expected higher growth rates on the expenditure side.

In structural terms, the budget balance is estimated at 2.2% of GDP on average during 2025-2028, where the structural primary balance is forecast to remain strong at 3.6% of GDP, on average.

Revenue, 2025-2028

During the medium term, public revenue is forecast to grow in line with the baseline macroeconomic scenario, driven mainly by private consumption, albeit falling gradually as a percent of GDP, as the double-digit growth rates of public revenues in 2024 are not expected to continue since the economy is reaching its potential levels. More specifically, revenue as a percent of GDP is forecast to reach 44.7% in 2025 falling by 0.5 percentage point of GDP from 45.2% in 2024, and drop further by 0.8 percentage points at 43.9% of GDP in 2026. The expected significant fall of public revenue in 2027 by 1.9 percentage points of GDP, at 42% of GDP from 43.9% of GDP the year before, is mainly attributed to the retroactive payments to the New Pension Scheme, which took place during 2024, 2025 and 2026, as well as to the methodological treatment of revenue under the RRP. In 2028, public revenue is forecast to reach 41.5% of GDP, well above its historical average.

Expenditure, 2025-2028

Public expenditure is forecast to grow during the medium term, mainly in line with the expected path of Cyprus' RRP. More specifically, public expenditure as a percent of GDP is forecast to reach 42% in 2025 exhibiting an increase of 0.7 percentage points compared to 41.3% of GDP in 2024. The forecasted increase of 7.4% in public expenditure in nominal terms during 2025, is attributed both to the expected projects that will take place in the context of the RRP, as well as to the impact of the discretionary measure, especially regarding the mortgage to rent scheme and the provision of general increases of the order of 1.5% on the basic salaries of general government employees, applicable on 1st October 2024. In 2026 public expenditure is expected to fall by 0.7 percentage points reaching 41.3% as a percent of GDP and then fall further by 1.4 percentage points to 39.9% of GDP in 2027, due to the methodological treatment regarding the surplus of the Fund under the New Pension Scheme of public sector's employees, as the retroactive payments of the state to the Funds will no longer take place, and to the termination of the RRP projects. Finally, in 2028 public expenditure is expected to reach 39.3% of GDP, close to its historical average.

The growth rate of **net nationally financed primary expenditure** is forecast to reach about 5.9%, 5%, 4.5% and 4.3% in 2025-2028, respectively, averaging at 4.9% during the medium term.

Public debt, 2025-2028

Public debt as a percent of GDP is forecast to continue its downward trend, falling further by end-2025 to 64.1%. During 2026-2028 debt-to GDP ratio is expected to hover around 59%, 53% and 47%, respectively.

Table 4: Main fiscal variables					
	2024	2025	2026	2027	2028
Net nationally financed primary expenditure	7.0	5.9	5.0	4.5	4.3
Net lending/borrowing	3.9	2.7	2.6	2.1	2.1
Primary balance	5.4	4.3	4.0	3.5	3.3
Structural balance	2.7	1.8	1.6	1.1	1.2
Structural primary balance	4.2	3.3	3.1	2.5	2.4
Debt	68.9	64.1	58.8	53.3	47.4
Gross debt	-8.5	-4.8	-5.3	-5.6	-5.9

4.6 DISCRETIONARY REVENUE MEASURES

Table A5 (Annex 1) presents the estimated impact of discretionary revenue measures for 2023 and 2024. The total impact from the revenue measures described below is estimated at around 0.3% and 0.9% of GDP in 2023 and 2024, respectively.

In the context of the high inflation rates and especially with regards to the significantly increased energy prices, the Government has proceeded with packages of targeted and horizontal measures to cushion the impact of the rising inflation. More specifically, from November-2021, the VAT rates on the electricity consumption on electricity bills were reduced, from 19% to 5% for the vulnerable consumers and from 19% to 9% for the rest of the households and businesses. The termination of the measure, in August 2022, resulted to the positive impact on the accounts of the general government for 2023, of about 0.1 percent of GDP.

At the same time, the extension of the reduction of the excise duties on fuels (8.3 cents per litre for all consumers), which started in March-2022, was set to end in June 2024. Its impact for 2023 and 2024 will ameliorate the general government accounts at the magnitude of 0.04 and 0.1 percent of GDP, respectively.

As per the Social Security Contributions Law, the contribution rates in the context of the Social Security Fund increase every 5 years by 1pp (0.5pp paid by the employee and 0.5pp paid by the employer). The most recent increase put into effect as of 1st January 2024 is estimated to impact positively the revenue side by 0.5 percent of GDP.

Furthermore, the new Civil Servants Pension Scheme, which is based on a Law of 2022 benefiting Civil Service Employees and the broader Public Sector (including Municipalities and Community Boards) employees was in force on 1st January 2023. The employer and the employee pay a corresponding amount on both sides at a rate equal to 5% of the member's monthly pensionable benefits. The payment of the amounts specified begins on the day that the employee becomes a member of the Plan and ends with his/her retirement from the state service or the broader Public Sector. The contributions received in the context of the Scheme benefited the

revenue side of the general government accounts by about 0.2 percent of GDP. In addition, the retroactive payments covering the years before 2023, which will take place during 2024-2026, are estimated to increase the revenue side by 0.4 percent of GDP in 2024.

In March 2024, the Council of Ministers decided the Abolition of the Annual Levy of €350 payable to the Registrar of Companies and Intellectual Property by all registered entities. This measure will have an impact of reducing revenues at around 0.1 percent of GDP per year, starting in 2024.

In the context of the 2025 budgetary process the extension of the zero VAT rate on basic goods until end-September 2024 was added. More specifically, from early-May 2023 until end-September 2024 (initially decided until end-October 2023, then until end-April 2024 and then until end June-2024), a zero VAT rate is applied on bread, milk, eggs, baby foods, baby and adult diapers, as well as female hygiene products. Sugar and coffee were added to the list as of November 2023, as well as meat and vegetables as of December 2023. The measure is expected to have a cost of 0.06 percent of GDP in 2023 with an additional impact of 0.05 percent of GDP in 2024.

The House of Representatives voted, in December 2023, for the reduction of the extraordinary defence levy on interest receivable from 30% to 17%. It is in force since 01/01/2024 with an annual fiscal cost of 0.05 percent of GDP and it concerns every resident taxpayer who receive interest subject to special defence contribution.

Lastly, in order to follow Commission's intention to change the recording practices for fiscal policy measures for countries that have maintained non-indexation of personal income tax brackets for a prolonged period of time, a new measure has been introduced. In particular, the measure concerns a methodological treatment to adjust the personal income tax brackets to the inflation rate. The difference between the non-indexation and the hypothetical full annual indexation at the inflation rate is recorded as a revenue increasing measure which it is estimated to have an impact of around 0.11 percent of GDP for 2024.

5. CONTINGENT LIABILITIES

The Treasury of the Republic of Cyprus prepares a report which analyses the **government's exposure to risks arising from guarantees** provided to various entities, the potential financial impact of events such as the COVID-19 pandemic and the Ukraine war and expected losses from these guarantees. The report uses the methodology recommended by the European Stability Mechanism (ESM) for managing credit risk on Cyprus Government-guaranteed loans. It provides a detailed analysis of outstanding government-guaranteed loans, loan status (e.g., performing, non-performing) and expected losses over three years based on different scenarios. The report's scope is to evaluate the risks associated with government guarantees and their potential impact on public finances.

As of December 2022, the outstanding government guarantees total to €1.632 billion. These are distributed across loans, guarantees related to Hellenic Bank Asset Protection Scheme (APS) and debt.

The Hellenic Bank Asset Protection Scheme (APS), which is a key part of the guarantees portfolio, has seen a reduction in its covered loan balance to €1.561 billion by the end of 2022. The Cyprus government guarantees 90% of losses under this scheme, but no losses are expected due to the actions taken by SEDIPES (ex-Cyprus Cooperative Bank). Most loans in the APS (92.06%) are performing, but non-performing loans (NPLs) represent 7.94% of the outstanding balances. The risk associated with NPLs is deemed high, especially for individual loans, where the collateral is often located in occupied areas of Cyprus. A significant portion of the called guarantees (those already demanded by lenders) remains unpaid.

The report also discusses the impact of two major external events, i.e. the Covid-19 Pandemic and the conflict in Ukraine. Regarding Covid-19 Pandemic, while the immediate impact on the portfolio was limited, future risks remain high due to individuals' reduced ability to repay loans. Regarding the conflict in Ukraine, rising commodity prices have impacted the financial stability of borrowers, increasing the risk of defaults, particularly among individuals.

The expected losses for the government's guarantee portfolio are calculated using the Probability of Default (PD) and Loss Given Default (LGD) rates and amount to €83 - €120 million for 2023, €16 - €18 million for 2024 and €17 - €18 million for 2025. These losses represent the government's exposure under different scenarios and assumptions, including changes in economic conditions, such as the country's credit rating.

In addition to the contingent liabilities arising from state guarantees, the Ministry of Finance is currently working on integrating climate change risks into the macro-modelling and fiscal-budgetary planning. It should be noted that in the Fiscal Risk Statement, which is submitted each year alongside the national budget, the Ministry identifies contingent liabilities in relation to disaster, climate and nature event, however these are not quantified. In this context, the Ministry of Finance has signed an MOU with the Economics Research Centre of the University of Cyprus (ERC), to conduct a research study on the impact of climate change on the real and potential GDP, on public finances and on key sectors of the economy of Cyprus. The study, which will be delivered in three stages, is expected to be completed by December 2025. The thematic box in Annex 4 provides a summary of the findings of the study produced by the ERC until Summer 2024, on the macroeconomic effects of the climate change.

6. DEBT SUSTAINABILITY ANALYSIS

Given the fundamental challenge of resource constraints, borrowing is commonly used to finance important development programs and projects creating a burden of debt repayment which could overwhelm a country's finances, at worst leading to default. Although the economic development is considered as a critical component that drives economic growth in an economy, an elevated debt could likely heighten the tension between meeting important country development goals and restraining debt vulnerabilities. To properly assess a country's debt sustainability, it is important to cover all types of debt that pose a risk to a country's public finances.

Fiscal sustainability is one of the key priorities of the authorities and economic policies are designed to maintain fiscal position and debt at prudent levels, in line with the reference values included in the Treaty of the functioning of the EU. Therefore, Cyprus prepared its plan in a manner that ensures the appropriate political commitment and national ownership while debt sustainability is safeguarded.

In this context, the debt level evolution over the medium term is estimated using the Commission's debt sustainability analysis (DSA) model. Using the commonly agreed methodology and the authorities' assumptions for 2024-2028, the debt level as percentage of GDP is estimated for the 10 years after the end of the plan (2029-2038). The methodology assumes a "no-policy-change" scenario and takes into account the fiscal position of 2028, the closure of the output gap (the economy grows at its potential level), the development of interest rates in the medium term and the long-term challenge of ageing population, by incorporating in the model the fiscal costs of ageing as calculated in the Ageing Report of 2023.

The DSA methodology is the same as the methodology used by the Commission to estimate the reference trajectory, which the European Commission transmitted on 20 June 2024 to Cyprus as prior guidance for the preparation of its Plan for the period 2025-2028, in line with Article 5 of Regulation. Based on the debt sustainability analysis implemented by the European Commission for the reference trajectory, the average net primary expenditure growth over the plan period 2025-2028 was determined at 4.9% with the debt path indicating compliance with the requirements of the Regulation. Specifically, the said primary expenditure growth ensures that, without further budgetary measures, gross public debt will follow a downward path over the plan period with an average decline of 4.2% over the period plan reaching 53.6% of GDP at the end of 2028. It is highlighted that the projected gross public debt ratio is maintained below the reference value of the Maastricht criteria from 2027 onwards. The Commission's reference trajectory is presented in detail under Annex 3.

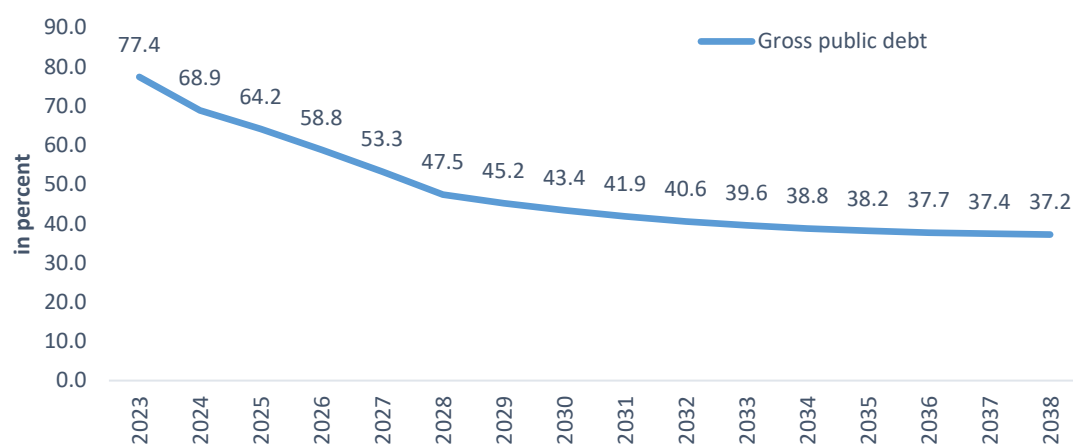
Following the communications with the European Commission, the authorities proceeded to the acceptance of the proposed methodology and general principles by the European Commission on debt sustainability analysis.

6.1 DSA BASELINE SCENARIO

A no-fiscal-policy-change assumption is applied by the authorities, with the assumptions that primary expenditure is modified by changes in the cost of ageing as projected in the 2024 Ageing Report and revenue remaining broadly stable as a share of GDP. According to the DSA model, the gross public debt continues its downward path after the end of the adjustment period (2029 -2038) with the annual average reduction being 1.0% and the public debt as a percent of GDP reaching 37.2% by the end of 2038. It is highlighted that the projected gross public debt ratio is maintained below the reference value of the Maastricht criteria from 2026

onwards. Figure 1 below illustrates the debt evolution of the public debt as a % GDP for the period 2023 to 2038, under the baseline scenario.

Figure 1: Evolution of gross public debt for the period 2023-2038



Although the gross debt is on a downward path over the period 2025-2038, the debt change for the said period is at a diminishing rate. The change of debt is affected by the primary balance, the snowball effect and the stock flow adjustments over the selected period. Based on the DSA results, the main factor, which under the primary balance, contributes to the diminishing rate of the debt change is the cost of ageing which is on an upward path over the period 2025-2038. The snowball effect contributes positively to the reduction of the public debt as a result of the projected high values of growth and inflation, however, the impact is eliminated throughout the selected period as the values of said indicators move at their equilibrium levels. On the other hand, the interest/growth- rate differentials are assumed to shrink and become less favourable to the debt change due to the upward path of the nominal implicit interest rate on debt over time. In conclusion, the negative effect on the debt change due to the increasing cost of ageing is eliminated by the favourable impact of the primary balance and the snowball effect. Table 5 below, indicates the change in gross public debt and the key debt drivers contributed to the change of debt over the period of the MTP 2025-2028 as well as over a period of 10 years after the end of the MTP, under the baseline scenario.

Table 5: Debt change and key debt drivers under the baseline scenario														
	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034	2035	2036	2037	2038
Primary balance	-4,3	-4,0	-3,4	-3,3	-2,5	-2,2	-2,0	-1,8	-1,6	-1,4	-1,2	-1,0	-0,9	-0,8
of which ageing costs	+0.0	+0.0	+0.0	+0.0	+0.8	+1.0	+1.3	+1.5	+1.7	+1.8	+2.1	+2.2	+2.3	+2.4
Snowball effect	-2,6	-2,5	-2,2	-1,8	-0,6	-0,5	-0,4	-0,4	-0,3	-0,3	-0,3	-0,3	-0,3	-0,3
Stock flow adjustment	2.1	1.2	0.2	-0.7	0.9	0.9	0.9	0.9	0.9	0.9	0.9	0.9	0.9	0.9
Total change in debt	-4.8	-5.3	-5.5	-5.8	-2.2	-1.9	-1.5	-1.3	-1.0	-0.8	-0.6	-0.4	-0.3	-0.2

Based on the DSA model results, we can conclude that the net expenditure path proposed in Section 4 of the Plan is adequate to ensure compliance with the fiscal requirements of Article 16(2) and (3) and the requirements set out in Articles 6, 7 and 8 of the Regulation. More specifically, without further budgetary measures, the following criteria are met:

- (a) by the end of the adjustment period, the projected general government debt ratio is put or remains on a plausibly downward path, or stays at prudent levels below 60% of GDP over the medium-term;
- (b) the projected general government deficit is brought below 3% of GDP over the adjustment period and is maintained below that reference value over the medium-term assuming that there are no further budgetary measures;

In addition to the aforementioned DSA-based criteria, the proposed net expenditure path ensures that the following three provisions are fulfilled:

- (c) The “deficit benchmark”: It ensures consistency with the corrective path referred to in article 3(4) of Regulation (EU) No.1467/97, where applicable (Excessive deficit procedure Regulation). A minimum annual adjustment of 0.5 pp. of GDP if the deficit exceeded 3% of GDP in the previous year with the adjustment to be measured in terms of structural primary terms over the transition period of 2025-2027 and in terms of structural balance as from 2028.
- (d) The “debt sustainability safeguard”: the projected general government debt-to-GDP ratio decreases by a minimum annual average amount of 1 percentage point (pp.) of GDP as long as the general government debt-to GDP ratio exceeds 90% and 0.5% pp. of GDP as long as the general government debt-to GDP ratio remains between 60% and 90%;
- (e) The “deficit resilience safeguard”: The fiscal adjustment continues until the deficit level in structural terms reaches the common resilience margin of 1.5% of GDP. Until the structural balance is above or equal to -1.5% of GDP, the annual improvement in the structural primary balance should be at least 0.4 pp of GDP or 0.25 pp of GDP in the case of an extension of the adjustment period.

Based on the debt sustainability analysis, an average annual net primary expenditure growth over the plan period 2025-2028 of up to 6.5% can also result to the fulfilment of DSA-based criteria. However, the authorities are proposing an average annual net primary expenditure growth of 4.9%, which is compliant with the Commission’s reference trajectory, to decrease any risk of non-compliance.

It should be noted that the authorities’ projections do not take into account the upcoming revision of historical GDP, which could possibly result in a higher potential GDP base. It is estimated that an underestimation of a 1 percentage point in the growth of the potential GDP, *ceteris paribus*, results to an increase in output gap of about 1 percentage point of GDP and consequently to an underestimation of the structural balance of 0.5 percentage points of GDP. The authorities believe that the above-motivated should be taken into consideration in the Commission’s assessment since the publication of the revised GDP and its components may prove the need for the upward revision of the growth of the potential.

6.2 DSA STRESSED SCENARIO AND STOCHASTIC ANALYSIS

As in the common methodology, to account for macroeconomic uncertainty and ensure that debt plausibly declines, even under more adverse assumptions, three stress tests are applied.

For comparison purposes, the three stressed tests scenarios are assessed against the adjustment scenario, as proposed by the Commission services, which assumes an adjustment period of 4 years followed by a 10-year no-fiscal-policy change period. For the period 2029 to 2038, debt to GDP ratio in the adjustment scenario continues its downward path at higher rates compared to the baseline scenario, reaching 27,9% of GDP by the end of 2038. The annual average change in debt in 2029-2038 in the adjustment scenario is -2.0%, compared to the -1.0% in the baseline scenario. This is attributed to the primary balance, which under the adjustment scenario is higher compared to the baseline scenario due to the lower impact of the cost of ageing.

The first stress test is the “Financial stress” scenario under which it is assumed that market interest rates are temporarily increase for one year by 1pp., plus a risk premium for high-debt countries. The second stress test is the “Lower structural primary balance (SPB)” scenario under which it is assumed that the SPB will be reduced by 0.5 pp. of GDP in total, with a reduction of 0.25pp. each year over the first two years, and to remain at that level afterwards, plus changes in the cost of ageing and, the third stress test is the “interest/growth rate differential ($r-g$)” scenario under which it is assumed to be increased by 1 pp. over the projection horizon.

Under the “Financial stress” scenario, the market interest rates both in the short-term and in the long-term are assumed to be increased by 1pp. in 2029 compared to the adjustment scenario reaching 3.8% and 4.6% respectively. As a result, the nominal implicit interest rate on debt marked an increase in 2029 by 0.1pp. reaching 2.8% whilst the average nominal implicit interest rate for the period 2029-2038 is determined at 3.0%. Despite the increase on interest rates, the gross public debt is projected to reduce over the period 2029-2038 by -1.9pp. on average, slightly slower than the -2.0% adjustment scenario, reaching 28.1% of GDP in 2038. The change of debt is mainly affected by the primary balance and the snowball effect and to a lesser extent by the stock flow adjustments over the selected period. As mentioned above, based on the “Financial stress” scenario, the main factor, which under the primary balance, contributes positively to the reduction of the public debt is the structural primary balance (before the cost of ageing) which is on an upward path and the cyclical component which is on a downward path. On the other hand, the factor, which under the primary balance, contributes to the diminishing rate of the debt change is the cost of ageing which is on an upward path over the period 2025-2038. Despite the increased average nominal implicit interest rate for the period 2029-2038, the interest expenditure is on a downward path due to the significant reduction of the public debt to GDP. In conclusion, the negative effect on the debt change due to the increasing cost of ageing is eliminated by the favourable impact of the primary balance and the snowball effect.

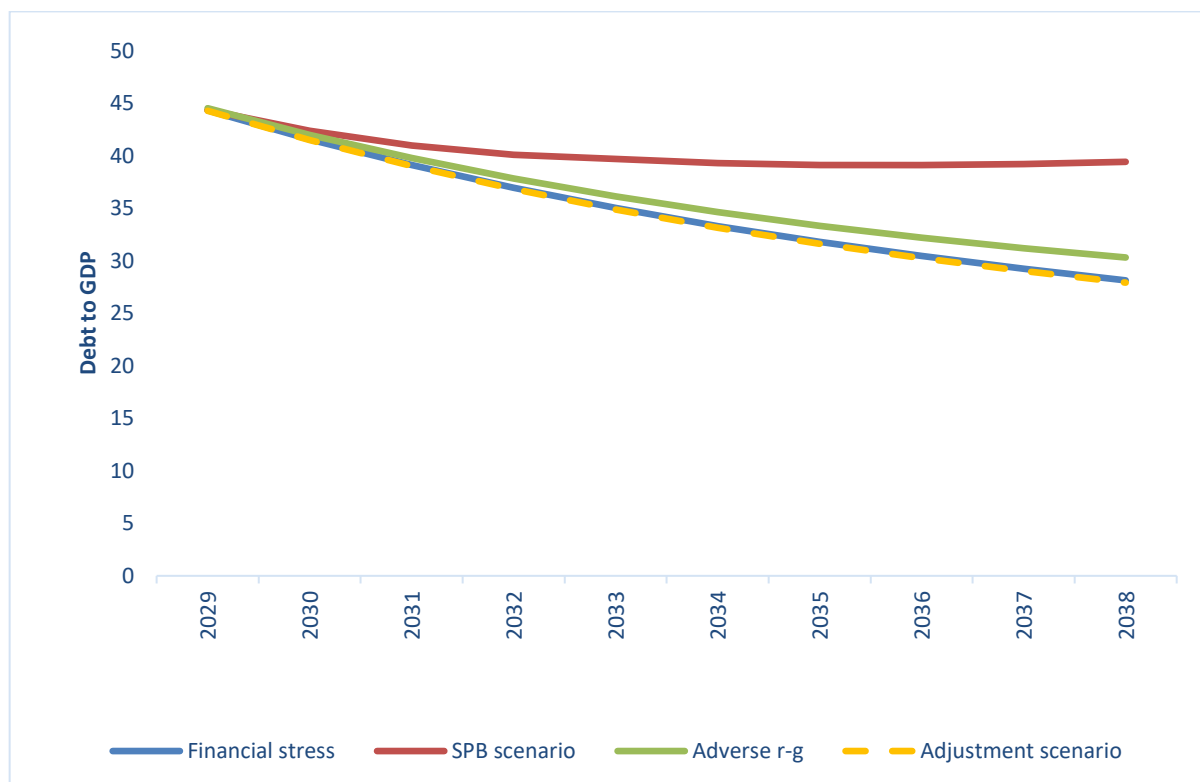
With regards to the “Lower SPB” scenario, the structural primary balance reduced each year by 0.25 pp. over the first two years (2029-2030) after the adjustment period, from 2.4% in 2028 to 2.2% and remains at 1.9% afterwards until to 2038. The reduction of the structural primary balance in conjunction with the upward path of cost of ageing contribute to the diminishing rate of public debt over the period 2029-2038. Despite the negative impact of the reduced structural primary balance and increased cost of ageing over the period 2029-2038, the gross public debt continues to be on a downward path and reaches 39,5% of GDP in 2038, with an average annual debt reduction of -0.8%, which is slower compared to -2.0% under the adjustment scenario.

The third stress test, “adverse $r-g$ ” scenario results to the diminishing rate of public debt over the period 2029-2038 due to the reduced snowball effect compared to the adjustment scenario. Under this scenario, the gross public debt continues to decline over the period 2029-2038 by -1.7% on average, compared to -2.0% under the adjustment scenario, reaching 30.3% of GDP in 2038.

Figure 2 below, illustrates the debt trajectory under the above three stress tests compared to the adjustment scenario for the period 2029 – 2038. It seems that under all scenarios, debt to GDP ratio continues its

downward path with the “Financial stress” scenario following very closely the adjustment scenario. The “SPB” scenario is considered as the less favourable scenario compared to the other two stress tests since the annual average debt reduction over the period 2029-2038 is projected to be around -0.8% compared to -1.7% and -1.9% under the “Adverse r-g” scenario and “Financial stress” scenario, respectively.

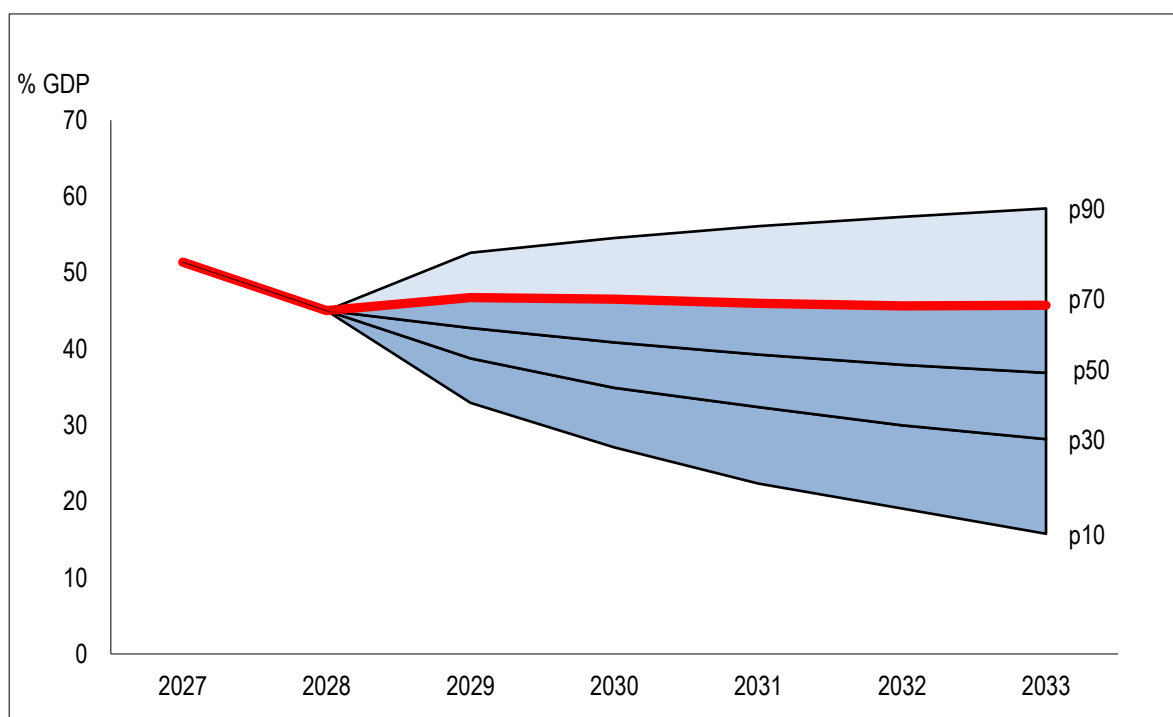
Figure 2: Debt trajectory under adjustment and deterministic stress tests scenarios



Stochastic simulations are also applied by the authorities around the adjustment scenario to capture a wide range of uncertainties surrounding debt dynamics by taking into consideration country-specific conditions such as volatility in the past and the correlation between the different variables. Stochastic shocks are simulated for five variables, namely primary balance, the nominal short and long-term interest rates, the nominal GDP growth rate and the exchange rate which are derived from Eurostat, Organisation for Economic Co-operation and Development (OECD) and the European Central Bank (ECB). Based on the stochastic analysis, the sample period ranges from Q1_2000 to Q3_2023 covering the period 2009, 2012-2014 and 2020 when the nominal growth rates of Cyprus were on a negative territory and the increased interest rates in period Q1_2023 to Q3_2023.

Despite the above specific conditions, based on the stochastic analysis, debt to GDP ratio is projected to decrease in the 5 years following the adjustment period to 29.4% with probability 70% by the end of 2033, in line with the threshold used in the Commission’s reference trajectory.

Figure 3: Stochastic debt redemptions in the period 2029-2033



Based on the DSA model results, we can conclude that even under adverse scenarios, the proposed net expenditure path is adequate to ensure compliance with the fiscal requirements of Article 16(2) and (3) and the requirements set out in Articles 6, 7 and 8 of the Regulation.

To conclude, the main policy objective of the government remains the safeguarding of the macroeconomic stability in order to facilitate growth and job creation. In addition, long-term fiscal policy will ensure fiscal sustainability through a sound fiscal position in the medium term and reducing public debt in a sustainable manner. At the same time, the Government of Cyprus is focusing on the implementation of key structural reforms as underlined in the next section, in order to increase the potential output of the Economy.

7. REFORMS AND INVESTMENTS

Cyprus continues to implement a comprehensive set of reforms and investments in its efforts to boost growth, achieve a competitive and diversified economy, maintain macroeconomic stability and address the challenges identified in the context of the European Semester under the country specific recommendations. It also implements measures under the four European Union's common priorities of (i) a fair green and digital transition, (ii) a social and economic resilience, (iii) energy security, and (iv) the build-up of defence capabilities.

The main reform and investments relate to improving the business environment, promoting the diversification of the economy, addressing challenges and inefficiencies in the public sector, addressing labour market, education, skills and social challenges, strengthening the resilience and capacity of the health system and facilitating the green and the digital transition. These reforms and investments are financed by national funds, as well as EU funds, such as the Recovery and Resilience Plan (RRP) and the Cohesion Policy Programme "THALIA 2021-2027".

7.1 SOURCES OF FUNDING

The **Cyprus RRP** is the main source of financing of investments and reforms addressing the CSRs. It was approved by the Council of Ministers on the 28th of July 2021 with an objective to strengthen the economy's resilience and the country's potential for economically, socially and environmentally sustainable long-term growth and welfare. It includes 136 measures, 61 reforms and 75 investments, with a total budget of €1.22 bln (1.02 bln in grants and €200 mln loans). 45% of this budget is directed towards green transition and 25% towards digital transition. It includes 282 milestones and targets that are distributed under the following 6 Axes:

- Public health, civil protection and lessons learned from the pandemic
- Accelerated transition to a green economy
- Strengthening the resilience and competitiveness of the economy
- Towards a digital era
- Employment, education and human capital
- RePower EU

In addition to the RRP, significant investments are promoted through **the Structural Funds**, under the investment Programme "THALIA 2021-2027" that covers all four Cohesion Policy Funds (ERDF, Cohesion Fund, European Social Fund+ and Just Transition Fund). The Programme was approved in July 2022, with Cyprus being the first Member State that signed the Partnership Agreement and relevant Cohesion Policy Programme. The Programme has a budget of €1.5 bln (EU contribution: €969 mln and national contribution €519 mln). Apart from this allocation, the Government of the Republic of Cyprus committed to invest additional €300 mln to the Programme (20% overbudgeting), showing its dedication towards green and digital transition, which make up the main pillars of investment in the Programme. THALIA 2021-2027 covers five Policy Objectives with the allocation being:

- Policy Objective 1 for a Smarter Europe 16%
- Policy Objective 2 for a Greener Europe 45%
- Policy Objective 3 – A more connected Europe 2%
- Policy Objective 4 for a Social Europe 23%
- Policy Objective 5 for a Europe closer to citizens 9%

The Programme's activation is well under way with around €900 mln (more than 60% of the Programme's budget) already announced and published in calls for submitting proposals.

7.2 REFORMS AND INVESTMENTS ADDRESSING CSRS

Indicative reforms and investments that are currently being promoted to address the CSRs are listed below, starting with those addressing the most recent CSRs (2024) and going backwards:

1. **Submission of Medium-Term Fiscal-Structural Plan:** The draft MTFSP has been submitted to the European Commission on 15th of October. This responds to CSR 2024.1 Sub.1.

Priority: Social and economic resilience.

2. **Revision and Update of the Cyprus National Strategy on Adaptation to Climate Change:** The revision of this strategy takes into consideration the new available information of climate change in the eastern Mediterranean and Middle East region and the contents of the new EU adaptation strategy and foreseeing to the support for the deployment of Cyprus climate-related risk assessment and stress test, institutional, administrative and sectoral capacity building contributing to enhancing stakeholder engagement. A TSI project was granted for this strategy that was signed in November 2023, started in January 2024 and expected to be finalised in late 2025. This reform response to CSR 2024.2 Sub.1 and CSR 2024.4 Sub.2 as the implementation of this strategy will focus on institutional framework governing climate adaptation and will achieve sustainable water management practices in agriculture.

Funded by THALIA 2021-2027 Cohesion Policy- Cohesion Fund

Priority: A fair green and digital transition

3. **Governance framework of State-Owned Entities (SOEs):** This reform aims to further enhance the governance framework of the State-Owned Entities. The Government of Cyprus has received relevant technical assistance by the International Monetary Fund and the final technical report, entitled "Strengthening the Governance of the State-Owned Enterprises", was concluded in late August 2023. Notwithstanding the positive steps that have been undertaken by the Ministry of Finance over the last few years towards the improvement of the governance framework of the SOEs, the report recognizes that additional measures are needed to strengthen SOEs corporate governance and accountability practices. Following the detailed examination of the expert's findings, as well as other horizontal initiatives, the

Ministry of Finance submitted, in March 2024 an informative proposal to the Council of Ministers, highlighting the main recommendations. Based on these, an Action Plan has been formulated, which includes four pillars of actions, namely: (1) Categorization of the SOEs, (2) Enhancement of the monitoring framework, (3) Strengthening of the SOE's institutional framework and (4) Issues related with the SOE's boards. It is anticipated that the Action Plan, following the conclusion of the consultation with the main public bodies, will be submitted to the Council of Ministers by the end of October 2024. This reform responds to CSR 2024.3 Sub.1, CSR 2023.3 Sub.1, CSR 2022.3 Sub.1 and CSR 2019.1 Sub.2 as it promotes the improvement of the governance of state-owned enterprises in line with international standards.

Funded by National Funds

Priority: Social and economic resilience

4. **Addressing Skills Mismatch Between Education and the Labour Market:** This reform aims to address the skills mismatch between the labour market and the Secondary and Higher Education system. It started in November 2022 with the implementation of the research project of the Department of Higher Education (DHE) of the Cyprus Ministry of Education, Sport and Youth (MESY) entitled "Development of a National Graduate Tracking Mechanism and Design and Implementation of an Employers' Skills Survey". The following actions are currently under development and scheduled to be completed by end of 2026: Reform of Curricula in Secondary General Education and Secondary Technical and Vocational Education and Training, Upgrade of labs, Professional Development of educators, Development of new programs of study. This reform responds to CSR 2024.3 Sub.2 by contributing to the improvement of skill levels and bridging the gap between Higher and Secondary Education educational outcomes and labour market needs.

Funded by RRF C5.1R1

Priority: Social and economic resilience

5. **New System of Evaluation of the Educational Work and the Educators:** This reform aims to improve the quality of education and consequently students' educational outcomes by modernizing and updating the current teachers and schools' evaluation system and developing a single evaluation scheme for primary, secondary and technical and vocational education with differentiated elements. This contemporary evaluation system of schools and teachers will incorporate the training of teachers and evaluators. Based on the decision of the Council of Ministers (6th of September 2023) the process of the new Teacher and School Evaluation mechanism is institutionalized. Consultation with the three major teacher unions commenced in September 2024. The implementation of the reform will be completed by 30 June 2025. The relevant law will be implemented from the school year 2025-2026 and upon its entry into force at least 1100 teaching staff (teachers, deputy heads and school heads) will be trained for the new Teachers and School Evaluation system. At the same time, the process of self-evaluation and development of a Unified Action Plan for Improvement of the school unit is institutionalized. Its implementation in schools started in the school year 2024-2025. This reform responds to CSR 2024.3 Sub.2 as it strengthens teacher evaluation and improves skill levels and educational outcomes.

Funded by RRF C5.1R2

Priority: Social and economic resilience

6. **Teachers' Professional Learning:** This reform aims at providing opportunities for continuous professional learning to all teachers of all levels, in a systematic way, on a needs assessment basis, both of school and individual teachers. Around 45 schools of all levels participate in the program every year since 2017 when the reform was started. Teachers' professional development and learning is supported by the necessary facilitators, supporters, trainers, tools, and resources to enhance teaching and learning and provide an all-rounded experience to both educators and students. Also, around 13,000 in-service teachers attend professional learning activities and programs (compulsory courses, optional courses, intervention programs in schools) each year on different thematic areas. This reform responds to CSR 2024.3 Sub.2, as it strengthens continuous teacher training and improves learning outcomes.

Funded by National Funds

Priority: Social and economic resilience

7. **Development of Technical Vocational Education and Training (TVET):** This reform aims to develop and improve technical and vocational education and training in Cyprus, by improving the correlation between technical and vocational education and training and labour market needs, facilitating the transition from education to work, improving the overall quality of teaching and learning taking place in VET schools and structures and increasing student participation in VET education. The project started under THALIA for the period 2021-2027 with a total budget of €36 mln. Indicative actions and initiatives implemented via this project are the following: Introduction of new programmes of study in STVET, purchase of and access to modern technical equipment and infrastructures, evaluation and improvement of curricula, preparation of teaching materials, promotional actions to encourage increased student participation in STVET Improvement of special rooms and laboratories, purchasing teaching services from business experts and professionals, evaluations of STVET structures. Also, STVET Pupils' and MIEEK Students' work placements in industry, Inspections of pupils during their work placement, actions to increase the general public's awareness about the advantages of STVET in contemporary economical and societal context, creation of a national monitoring system tracking SVET graduates' access and success in the labour market, creation of a StVET online alumni community platform. This reform responds to CSR 2024.3 Sub.2 and CSR 2019.3 Sub.2, as it supports the increase of participation of learners in vocational education and training thus addressing the imbalances between labour supply and demand and further increasing the capacity and attractiveness of Vocational Education and Training programmes.

Funded by THALIA 2021-2027 Cohesion Policy- ESF+

Priority: Social and economic resilience

8. **VET Strategy:** A new Strategic Planning for Secondary Technical and Vocational Education and Training (STVET) 2024-2028 is under preparation that will cover all the programs implemented under the

Directorate of STVET: Initial TVET, Public School of Higher Vocational Education and Training (MIEEK), Secondary VET Apprenticeship system, Evening Schools of Technical and Vocational Education (ESTEE) and Lifelong Learning Programmes of Vocational Education and Training (afternoon and evening Classes). The vision is to ensure an integrated, attractive, flexible and high-quality Technical and Vocational Education and Training System, that responds to the current and future needs of the Cypriot economy and society as they emerge from the constantly changing local and international economic and technological environment, educate and empower individuals (pupils and students) in basic skills as well as in specific professional knowledge, skills and competences to better exploit opportunities and address challenges in society, the economy and workplace. The format of the new Strategic Planning includes the following topics: Internal Environment, Initial TVET and Vocational training programs, External Environment (Vocational training in Cyprus and Europe, Labor market, European recommendations), SWOT analysis, Vision and Strategic Targets, Means for achieving strategic targets. The Strategy is estimated to be completed by the end of 2024. This reform responds to CSR2024.3 sub2, as it increases the attractiveness of Vocational Education and Training programmes.

Priority: Social and economic resilience

9. **VET school in Larnaca:** Within the context of the Just Transition Fund, the planning of the new Technical School of Green Professions in Larnaca has been completed with a budget of €34 mln. The construction of the school will begin in the early months of 2025. It is expected that a contract for the construction of the school will be signed by the end of 2024. Submitted tender offers have already been evaluated. The construction will be completed by the end of 2027. This reform responds to CSR2024.3 sub2, as it increases the attractiveness of Vocational Education and Training programmes and upgrades the education system in Cyprus.

Funded by THALIA 2021-2027, JTF

Priority: Social and economic resilience

10. **Actions for School and Social Inclusion+ (DRA.S.E.+):** This investment started in the school year 2021-2022, has a budget of €60 mln and it is applied to school units of all levels (Public Kindergartens, Primary Schools, Gymnasiums, Lyceums, Technical and Vocational Education and Training Schools), which have been selected on the basis of specific objective and measurable criteria, regardless of the geographical area in which they are located. Among other things, the following actions are offered:

- Free supportive teaching and creative activity Projects for students and parents, in the morning and afternoon time
- Teaching the Greek language in the morning and afternoon time, for students and parents with an immigrant biography
- Additional psychosocial support services for students and parents, through the creation and operation of Information and Psychosocial Support Centers
- Supply of support/equipment and educational material to schools.

During the school year 2024 - 25 it is applied to school units of all levels (55 Public Kindergartens, 91 Primary Schools, 29 Middle/High Schools, 3 Technical and Vocational Schools, Education and Training), which have been selected on the basis of specific objective and measurable criteria, regardless of the geographical area in which they are located and covers approximately 27.18% of the student population in Cyprus. This investment responses to CSR 2024.3 Sub 2 and CSR 2019.3 Sub 2, as it aims to upgrade the education system in Cyprus.

Funded by THALIA 2021-2027 ESF+ and National Funds

Priority: Social and economic resilience

11. Cyprus Lifelong Learning Strategy (CyLLLS): This reform provides a long-term strategic framework for the development of a knowledge-based society, in which every citizen will have learning opportunities for his knowledge, skills and attitudes, which will facilitate his personal and social growth, professional development, social inclusion, resilience and well-being. This will be achieved by improving the quality of the adult education sector, providing incentives to individuals and businesses, removing barriers, as well as increasing the visibility and strengthening of information and communication. The CyLLLS 2021-2027 was approved by the Council of Ministers on 30th of September 2022 (Decision No.: 93.682). This reform responses to CSR 2024.3 Sub.2 with regards to enhancing adult learning.

Funded by National Funds

Priority: Social and economic resilience

12. Training programmes for young people aged 15-29 not in education, employment, or training (NEETs): The acquisition of basic knowledge and skills to help young people aged 15-29 to enter the labour market. The reform was adopted on 8th July 2022 and it will be operational by Q4 2024. This response to CSR 2024.3 Sub.2, CSR 2020.2 Sub.4 and CSR 2019.3 Sub.2 by upgrading existing and acquiring new knowledge and skills in order to help young people to exploit the employment opportunities that arise in dynamic sectors of economic activity, such as the green and blue economy. Furthermore, it will prepare them suitably for the changing nature of work, especially to that related to digital transition.

Funded by THALIA2021-2027 Cohesion Policy- ESF+

Priority: Social and economic resilience

13. Individual Learning Accounts (ILAs) (pilot project): This reform provides credits to eligible groups of employed and unemployed persons to attend training programmes within the HRDA Scheme “Standard Multi-Company Training Programmes”, in order to acquire new and/or upgrade existing knowledge and skills. It was adopted on 8th July 2022 and it will be operational by Q1 2025. This response to CSR 2024.3 Sub.2, CSR 2020.2 Sub.4 and CSR 2019.3 Sub.2 as the involvement in training activities with the opportunities provided for reskilling and upskilling can enable the participants to remain competitive in the labour market, improve their employment opportunities, while at the same time enhances social cohesion.

Funded by THALIA 2021-2027 Cohesion Policy- ESF+

Priority: Social and economic resilience

14. Geographic Information System (GIS) to Support the Digital Transformation of Networks: This investment concerns the development of infrastructure, equipment, systems and applications that will render GIS as the backbone of the administration and support of smarter electrical grids that will feature automated operational procedures. It will also enable the participation in the forthcoming digital one-stop-shop for RES-E connection. The integration with MDMS and with ADMS is scheduled to be completed by Q3 2027. This investment responds to CSR 2024.4 Sub.1 as it contributes to the upgrading and expanding the grid and storage to accommodate an increasing share of renewables.

Funded by THALIA 2021-2027 Cohesion Policy- JTF

Priority: A fair green and digital transition

15. Digitalization of the Distribution System and the development of a Supervisory Control and Data Acquisition (SCADA) and Advanced Distribution Management System (ADMS): This reform consists of two main objectives: (1) Digitalization and modernization of Medium Voltage and Low Voltage grids and (2) Installation and operation of a modern SCADA/ADMS system and establishment of the National Distribution Control Centre. The upgrade of existing IT infrastructure is scheduled to be completed by Q2 2026. This reform responds to CSR 2024.4 Sub.1 and CSR 2022.4 Sub.2 as it upgrades the safety and functionality of the electricity grid and enhance the further penetration of Renewable Energy Sources (RES).

Funded by THALIA 2021-2027 Cohesion Policy- JTF

Priority: A fair green and digital transition

16. Development of a Fiber Optic Telecoms Network to Support the Demanding Communication Needs of the Distribution System in the Energy Transition: This reform consists of two main objectives: (1) Installation, administration and maintenance of the passive equipment (FO cables, terminal and auxiliary equipment) and (2) Installation, operation and maintenance of the active telecom's equipment. The definition of Topology and Selection of Technology/ Materials P.N., Pilot Optical Network, Tender for Materials, Network Equipment & Installation Services Pilot Network are scheduled to be completed by the end 2027. This reform responds to CSR 2024.4 Sub.1 and CSR 2022.4 Sub.2, as it upgrades the safety and functionality of the electricity grid and enhance the further penetration of Renewable Energy Sources (RES).

Funded by THALIA 2021-2027 Cohesion Policy- JTF

Priority: A fair green and digital transition

17. Mass Installation and Operation by the Distribution System Operator (DSO) of Smart Metering Infrastructure: This investment refers to the installation of smart meters aiming at the implementation of dynamic tariffs, that will encourage consumer engagement in demand response, support the growth of energy communities, and empower consumers to become active participants in the energy market. The relevant contract was signed on 24th of July 2024 and 250,000 smart meters will be installed by Q2 2026. According to CERA Regulatory Decision 02/2018, 400,000 smart meters should be installed by January 2027. This response to CSR 2024.4 Sub.1 and CSR 2022.4 Sub.2 by upgrading and expanding the grid and storage to accommodate an increasing share of renewables.

Funded by RRF C2.1I7

Priority: A fair green and digital transition

18. Guidance Documents for Renewable Energy Sources (RES) applications: This reform concerns the development of an online manual of procedures for developers of renewable energy production projects, addressing distinctly also small-scale projects and renewables self-consumers projects. The online information will indicate the One-Stop-Shop of the Ministry of Energy, Commerce and Industry, as the single contact point for applications. The guidance documents are expected to be in place by the end of 2024. This reform responds to 2024.4 Sub.1, as it accelerates the deployment of renewables, in particular by further streamlining permitting procedures.

Funded by RRF C2.1R3 and THALIA 2021-2027 Cohesion Policy- JTF

Priority: Energy security

19. Support Schemes for Energy Storage: This investment concerns the installation of energy storage systems in combination with the scheme of renewable energy sources, with the aim to improve RES penetration to Cyprus energy mix, reduce curtailments and enhance stability of the system. Three different schemes (namely Part A1, A2 and B) are envisioned targeting existing and new RES producers. The first scheme (A1) that involves existing RES producers with contract with the EAC Supply is expected to be completed by Q4 2024. Parts A2 and B are expected to be completed by Q1 2025. This investment responds to CSR 2024.4 Sub.1, as it facilitates targeted investments in the electricity system of Cyprus for enhancing efficient usage of energy.

Funded by THALIA 2021-2027 Cohesion Policy- JTF and National funds

Priority: A fair green and digital transition

20. Provision of environmental incentives in maritime transport: This investment provides Green Tax Incentives, as part of the Cyprus Tonnage Tax System, aiming to reward efforts to proactively reduce the greenhouse gas emissions in maritime transport. The incentives provide for a reduction of tonnage tax up to 30% for the qualifying owners of Cyprus and Community ships that use mechanisms - equipment for the environmental preservation of the marine environment and the reduction of the effects of climate

change. The incentives were adopted in March 2024. This investment responses to CSR 2023.4 Sub.1, CSR 2022.4 Sub.1 as investments are focused on the reduction reliance on fossil fuels and diversify the energy supply.

Funded by National Funds

Priority: A fair green and digital transition

21. Grant Scheme for the Encouragement of the Use of Renewable Energy Sources (RES): This investment promotes the installation of photovoltaic systems in existing dwellings, including residences used as the main and permanent place of residence by vulnerable electricity consumers. The first grand scheme launched in 2019 and over 30,000 dwellings have been granted. This response to CSR 2023.4 Sub.2 by extending and accelerating energy efficiency measures and also addressing energy poverty.

Funded by RRF C2.1I2

Priority: A fair green and digital transition

22. Electricity Interconnection Between Cyprus, Greece, and Israel: This investment, the "Great Sea Interconnector" is a significant energy infrastructure project that aims to connect the electrical grids of Israel, Cyprus, and Greece (via Crete) through a 1,000 MW subsea high-voltage direct current (HVDC) cable. The project's implementation will end Cyprus's energy isolation, achieve the EU member states' target of 15% electrical interconnection by 2030, contribute to the completion of the EU's internal energy market, enhance supply security, and reduce carbon emissions through electricity generated from natural gas and renewable energy sources. The project is in the final stage of permitting and is expected to be operational by 2029. This investment responses to CSR 2023.4 Sub.3, as it contributed to the development of electricity interconnection.

Funded by RRF C2.1I11

Priority: A fair green and digital transition

23. Saving – Upgrading Houses" Programme: This investment provides grants related to thermal insulation of the building shell, replacement of windows, installation of shading systems as well as the installation and/or replacement of technical systems (such as solar, photovoltaic, air conditioners, storage batteries, control systems, etc.) The first two calls of the scheme were announced in 2021 and 2023 with a total budget of €85 mln. By the end of July 2024, 1335 applicants finished their investments and received a total subsidy amount of €20,6 mln. The first two calls (total budget €85 mln) are funded through the THALIA 2021-2027 Programme – Cohesion Policy- ERDF. The third call funded from RRF with a budget of €30 mln and was announced on July 2024. This investment response to CSR 2023.4 Sub.4 and CSR 2022.4 Sub.5, as the extensive energy upgrading of existing households will enhance energy efficiency and use of Renewable Energy Systems.

Funded by RRF C2.1I5, THALIA 2021-2027 Programme – Cohesion Policy- ERDF and National Funds

Priority: A fair green and digital transition

24. **PEDIA project:** This investment aims to transform schools to zero energy schools and improve their energy efficiency and resilience. It sets a procedural framework to select existing buildings, based on pre-defined criteria, to implement energy renovations, while providing innovative financial solutions, which minimise transaction costs and engage the private finance community. The selection process of 25 schools from all the educational levels out of 167 which have applied was concluded in December 2021, the relevant infrastructure works started in 2022. The project entered at the 3rd phase of implementation where the first 5 schools have already been restructured and another 5 schools are in the process to become zero energy schools. The project was initially funded by the project Horizon and National Funds with the amount of €5 mln and now it is funded by THALIA with the amount of €22 mln until 2027. This investment responses to CSR 2023.4 Sub.4, CSR 2022.4 Sub.5, as investments are focused towards green transition.

Funded by THALIA 2021-2027 Cohesion Policy – ERDF

Priority: A fair green and digital transition

25. **Promoting widespread use of electric vehicles (EVs):** This scheme supports the purchase of Electric Vehicles and until now 5,800 electric vehicles of categories M1, M2-3, N, L1e-L7e and bicycles have been purchased. This investment will be completed by June 2026 and it responses to CSR 2023.4 Sub.6, CSR 2020.3 Sub.6, CSR 2019.4 Sub.1 as it promotes sustainable transport.

Funded by RRF C2.2I3

Priority: A fair green and digital transition

26. **Installation of publicly accessible EV charging points:** This Grant Scheme promotes the creation of the necessary infrastructure for electrification with the installation of 1,000 recharging stations, with the aim of providing free public access to an extensive network of recharging points for electric vehicles. It finances the installation of charging stations for electric vehicles with a target to install 1,000 charging points, with an intensity of 50% and a maximum amount of funding depending on the type of charger. Phase B of the Scheme is currently in effect and the installations should be completed by end of 2026. This investment responses to CSR 2023.4 Sub.6, CSR 2020.3 Sub.6, CSR 2019.4 Sub.1 as the use of electric vehicle is becoming friendlier thus promotes sustainable transport.

Funded by RRF C2.2I2

Priority: A fair green and digital transition

27. Digital One-Stop Shop to streamline RES projects permitting and to facilitate Energy Renovation in Buildings: The objective of the measure is to promote the implementation of RES projects by streamlining the RES projects permitting process. The reform also aims at accelerating the energy renovation of buildings. The reform shall consist in digitalizing the licensing permitting process for RES projects and establishing a single point of contact for technical and financial support for the purposes of energy renovation of buildings. The first phase, which concerns the digital submission of applications for the licensing of energy production projects from RES is under operation while, the second phase, which will enable the full digitalisation of procedures and electronic approvals of applications is expected to be completed before the end of 2024. This reform response to CSR 2022.4 Sub.2, as it accelerates the deployment of Renewable Energy Sources by enable the permitting procedures.

Funded by RRF C2.1R3

Priority: A fair green and digital transition

28. Infrastructure projects on Sustainable Urban Mobility Plans: This investment includes public transport infrastructure projects, such as new bus lanes (Nicosia, Limassol, Larnaca), new cycle lanes (Nicosia, Limassol, Larnaca), manufacturing and installation of 4,450 new bus stops and shelters and refurbishment of over 1,000 existing bus stops across Cyprus, 14 new bus stations with Infrastructure to support the future charging of electrified public transport fleets. This investment will be implemented until 2029 and it responses to CSR 2022.4 Sub.6 as it promotes the use of public transport and accelerates energy efficiency measures, contributing to the National Goal for emission reduction (NECP) and special directives for transport.

Funded by RRF C2.2I1 and THALIA 2021-2027 Cohesion Policy – ERDF

Priority: A fair green and digital transition

29. Enhancement, Modernization, and Upgrade of Cyprus Public Hospitals: This investment includes the enhancement of the Makarios Hospital for Children to offer a complete treatment of cases to children (June 2024 – June 2026), the construction of a new Mental Health Hospital and procurement of the latest technology attendant equipment (Phase 1, will be completed by October 2024), and the enhancement of the Limassol General Hospital & Construction and/or extension of Haemodialysis Unit at Limassol Hospital (completion by June 2026). This investment responses to CSR 2020.1 Sub.2 and CSR 2019.3 Sub.4 as it strengthens the effectiveness, accessibility and overall resilience of the healthcare sector supporting the recently introduced National Health System through various interventions. Investments towards this goal will both serve the benefit of the patients and the operability of the hospitals and public health authorities. They will also create the required environment that will enable the improvement of the working conditions of the health workers and enhance their ability to provide better services to patients enabling better health promotion and protection.

Funded by RRF C1.1I5

Priority: Social and economic resilience

30. Establishment of home structures for children, adolescents with conduct disorders, persons with disabilities and people in need of long-term care (LTC): This investment with a budget of €15,40 mln consists of the establishment of at least eight state structures for children or persons with disabilities and the establishment or renovation of at least eighteen homes for children, adolescents with conduct disorders and people in need of long-term care (through tender procedures and aid schemes). The implementation of the investment will be completed by 30 June 2026. The draft Agreement for the 5 buildings that will be signed between the Department for Social Inclusion of Persons with Disabilities (DSID) and the Cyprus Land Development Corporation (CLDC) has been submitted to the Law Office for legal vetting since November 2023. Efforts are being made for speeding up the finalization of the legal vetting. The design of the 5 buildings has been completed by the CLDC while building permits are still pending. Regarding 15 Buildings, the Social Welfare Services (SWS) conducted meetings with the District Local Government Organizations in July 2024 to discuss problems with the location of specific buildings. In addition, contacts have been made with the Presidents of the Union of Municipalities and Communities by the end of September 2024 and with the involved municipalities/communities for the exchange of views in the framework of consultation, in the beginning of October 2024. It is expected that the type of the projects and the location of the buildings will be finalised within October 2024 and that by mid-November 2024 the SWS will submit to the Competent Ministerial Committee a request for the approval of the state land that will be used for the development of the buildings. Regarding 6 Buildings a 1st Call of a Grant Scheme has been launched in February 2023, 10 applications have been submitted and 4 have been positively assessed. This investment responds to CSR 2020.1 Sub 2 as it strengthens the capacity of the health and social system and ensures quality and affordable provided services by (i) supporting the Republic of Cyprus to meet its obligations under the Refugee Act 2000 - 2016 to provide care and to safeguard the rights of unaccompanied minors who arrive in the Republic, (ii) meeting the housing needs for children and adolescents with particular difficulties who are placed under the guardianship of the social welfare services, (iii) enhancing community-based supported living structures for persons with disabilities to avoid institutionalisation and social exclusion and (iv) addressing gaps in long-term care services.

Funded by RRF C5.2I3

Priority: Social and economic resilience

31. Minimum Guaranteed Income (GMI): The scheme provides that any person whose income and other financial resources are not sufficient to cover their basic and special needs, as defined by the relevant legislation (L.109 (I)/2014), may request a granting of the minimum guaranteed income, which is provided in the form of financial support and /or services. This reform address CSR 2020.2 Sub.1 as it ensures a minimum socially acceptable standard of living for individuals and their families legally residing in the Republic of Cyprus, as long as they meet the necessary conditions.

Funded by THALIA 2021-2027 Cohesion Policy- ESF+

Priority: Social and economic resilience

32. Information and Training Centre for Employment and Entrepreneurial Action in Vulnerable Groups: This investment with a budget of €1.8 mln concerns the promotion of employment and the encouragement of entrepreneurship, mainly among the most vulnerable groups of the population. Specifically, the Center offers the following:

- Training and work integration / reintegration programs for people from socially vulnerable groups, in the field of home care for infants, toddlers, the elderly and the disabled.
- Employment of caregivers and expansion of home Care services.
- Facilitating the integration and reintegration of people into the labor market through programs and targeted actions that require their active participation.
- Raising awareness of professional bodies, businesses and employers on issues related to the promotion of employment.
- Providing information regarding integration and reintegration into work.
- Referral of interested parties to the Public Employment Service (PSS).
- Promotion of cooperation and networking of employment support structures and agencies.
- Identifying and supporting the development of the beneficiary's business profile.

This investment responds to CSR 2020.2 Sub1, as it offers networking and employment opportunities, particularly for vulnerable groups, improving a good work-life balance, tackle social exclusion, help with personal development, encourage business activity and offer social services in underdeveloped urban areas.

Funded by THALIA 2021-2027 Cohesion Policy- ERFD and National Funds

Priority: Social and economic resilience

33. Digitalization of services of PES: This investment concerns: (1) The development of the platform for digitalisation of the schemes offered by the Department of Labour, on an attempt to digitize the management of the Subsidy Schemes that the Intermediate Body announces and operates. Citizens and registered companies will be able to apply for participation in the schemes and have the ability to monitor the progress of their applications. The platform will digitize the application examination and payment processes and improve the services offered to citizens. Development is progressing according to plan with expected go-live date in early December. (2) The development of a Performance Management System for the PES. Through this platform PES will be able to set and monitor KPIs for all of its individual offices, digitize and improve their services and at the same time work towards making PES a well valued Employment Agency. Development is progressing according to plan with expected go-live in late November 2024. (3) The development of a platform for NEETs. Through this platform, the Public Employment Services (PES) will be able to identify early in the process and be able to track the status of those unemployed individuals that are neither in employment, education, training (NEETs) and be able to provide support to them. This platform is being developed internally by the Department of Information Services. Development is progressing well and the platform is expected to go-live towards the end of

November 2024. This investment responses to CSR 2020.2 Sub.2 and CSR 2019.3 Sub.1 as strengthens public employment services.

Funded by RRF C5.2I1

Priority: Social and economic resilience

34. Outreach Activities for NEETs aged 15-29 with the development of four mobile unit of PES: This investment with a budget of €3 mln started in January 2024 with duration 20 months and it will be completed in August 2025, while the contract can be renewed for another 21 months until May 2027. The total amount for the first contract is €680,000 plus VAT and for the second €714,000 plus VAT in case of the contract renewal. According to the results of the operation of the mobile units, until September 2024, 11,714 NEETs have been identified and approached by the Employment Counsellors for NEETs. After the provision of consultation, only 357 of them agreed to be referred for registration with the Public Employment Service (PES) and only 248 of them can be considered as beneficiaries of the project, according to the PES's evaluation. This investment response to CSR 2020.2 Sub.2 and CSR 2019.3 Sub.1 as strengthens public employment services.

Funded by THALIA 201 -2027 ESF

Priority: Social and economic resilience

35. Subsidy schemes of employment /including flexible work arrangements: Different schemes are promoted with response to CSR 2020.2 Sub.3 regarding flexible working arrangements that are funded under ESF - THALIA 2021-2027. The most important undergoing scheme is the Scheme for providing incentives for the employment of the unemployed by providing flexible forms of work through teleworking. This reform involves subsidising part of the salary costs of staff as an incentive for employers to hire unemployed people to work in various forms of telework. The duration of the scheme is until 2027.

Funded by THALIA 2021-2027 - ESF

Priority: Social and economic resilience

36. Training programmes focused on digital, green, blue, and entrepreneurship skills: This investment refers to training programmes implemented by certified Vocational Training Centres, for the acquisition of new and upgrading of existing digital skills, knowledge and skills related to the green and blue economy, and entrepreneurship knowledge and skills of the human resources of Cyprus (public, broader public and private sector employees, the self-employed and the unemployed). The investment began in December of 2023 and will be completed by 31st of December 2025. This responses to CSR 2020.2 Sub.4 and CSR 2019.3 Sub.2 as it increases participation in vocational education and training and helping persons to exploit the employment opportunities that arise in dynamic sectors of economic activity, such as the green and blue economy and will prepare them for the changing nature of work, especially to that related to digital and green transition.

Funded by RRF C5.1I2

Priority: Social and economic resilience

37. **National Promotional Agency (NPA):** This reform aims to address market failures in SMEs' access to capital and to promote the Government policy objectives, via the provision of tailored-made financial instruments and advisory services support. The roadmap for the creation and establishment of the NPA was approved by the Council of Ministers in April 2024 and the Ministry of Finance is currently working on the tender documents for acquiring the services of Legal Consultants for the drafting of the relevant legislation and regulations for the NPA's operations. This reform responses to CSR 2020.3 Sub.1 and CSR 2019.4 Sub.7 as it improves SMEs' access to finance.

Funded by RRF C3.3R4

Priority: Social and economic resilience

38. **Cyprus Equity Fund:** This investment supports the government's efforts to enhance access to alternative sources of finance, both by supporting innovative SMEs and attracting private investments. The Fund will be split into two compartments: a) the Acceleration Compartment which will provide initial financing to emerging entrepreneurs to research, assess and develop an initial concept and, b) the Venture Capital Compartment which will provide follow-on financing to successful graduates from the Acceleration Compartment, as well as direct investments to innovative companies which are not part of the Acceleration Compartment. The Government has entrusted the selection of the Fund Managers and the monitoring of the operations of the Fund to EIF. The EIF has selected the Fund (East Venture Capital Fund) which was established in December 2023 and it is expected to start investing in companies in autumn 2024. This investment responses to CSR 2020.3 Sub.1 and CSR 2019.4 Sub.7 as it facilitates access to finance for innovative SMEs and start-ups active in Cyprus.

Funded by RRF C3.3I6

Priority: Social and economic resilience

39. **Municipal Waste Management Plan:** This Plan aims to fulfil the obligations of Cyprus under Article 28 of the Waste Framework Directive (WFD) and identifies measures and actions to be implemented for sustainable waste management and to the transition of Cyprus towards a circular economy. The focus of the Plan which was adopted by the Council of Ministers on 28th of July 2022, is on moving away from mixed waste disposal and towards sustainable waste management, including measures to further promote separate collection, reuse and recycling, infrastructure measures for the appropriate management of waste, measures to improve extended producer responsibility systems, regulatory and economic measures, such as the establishment of deposit-refund systems and the introduction of a landfill tax. The Plan includes a total of 65 measures with a budget of more than €90 mln. The implementation of a number of these measures is supported by EU funding under the Cohesion Funds, the RRF, Life IP CYzero WASTE Program and Common Agricultural Policy. This reform response to CSR 2020.3 Sub.5 and CSR 2019.4 Sub.2

as by the implementation of the Plan and the related measures, investments are being focused towards water and waste management.

Funded by RRF C3.1I12 and THALIA 2021-2027 Cohesion Policy

Priority: A fair green and digital transition

40. Implementation of a Nationwide System for the Separate Collection of Municipal Waste: The implementation of this system, aims to the support of local authorities for the establishment of a separate collection system for municipal solid waste and the implementation of the Pay-As-You-Throw Schemes, the prevention, separate collection of waste in coastal and mountainous areas, the installation of green recycling kiosks and community composters in remote and semi-remote rural areas and the creation of repair and reuse centers. This reform started in 2021 and will be implemented until 2029. This reform response to CSR CSR 2020.3 Sub.5 and CSR 2019.4 Sub.2 as it promotes the separate collection of waste through the implementation of a number of EU funded programmes and focuses infrastructure measures and related investments on the creation of a appropriate network of facilities for the appropriate treatment of separately collected and mixed waste.

Funded by THALIA 2021-2027 Cohesion Policy

Priority: A fair green and digital transition

41. National Circular Economy Action Plan: This Plan includes targeted policies and actions aimed to strengthen and promote the Circular Economy in Cyprus. It also includes measures to promote separate collection and appropriate management of waste. The Action Plan, with an implementation period up to 2027, includes 22 measures 10 of them to be funded by the RRF and the rest by national or EU Cohesion Policy funds. It addresses specific priorities such as the promotion of synergies in achieving economies of scale, creating favourable market conditions to boost circular products, boosting new economic activities, restructuring existing modes of operations and regulatory reform requirements. This reform response to CSR 2020.3 Sub.5 and CSR 2019.4 Sub.2 as it focuses on promoting circular economy in businesses and industry.

Funded by RRF C3.1R4, C3.1I12, C3.1I9 and THALIA 2021-2027 Cohesion

Priority: A fair green and digital transition

42. Water Treatment Plants: This investment involves the refurbishment of the treatment systems at Water Development Department's water treatment plants in order to conform with the requirements of the new Directive (EE 2020/2184) on the quality of water intended for human consumption. These refurbishments will include installation of activated carbon polishing units at three water treatment plants (WTPs) (Tersefanou, Asprokremmos, Lemesos), the replacement of chlorination infrastructure at five WTPs (Kornos, Lemesos, Asprokremmos, Tersefanou, Kanaviou) and the expansion of the Asprokremmos WTP capacity by 10,000 m³/day. The installation at Tersefanou WTP was completed in March 2024, the

Contract for the installation at Asprokremmos WTP was signed on 31st of July 2024, the contract for the installation of activate carbon polishing for Lemesos WTP is expected to be signed in the end of October 2024, the Contract for Kornos WTP was signed on 28.06.2024, The Tender documents for the WTPs of Lemesos, Asprokremmos, Tersefanou, Kanaviou are currently under preparation. This reform response to CSR 2020.3 Sub.5 and CSR 2019.4 Sub.2 as by the implementation of the Water Treatment Plants, investments are being focused towards water management.

Funded by RRF C2.3I2

Priority: A fair green and digital transition

43. Kokkinokremmos Conveyor Project: The aim of this investment is to provide sufficient water to the District of Famagusta (Ayia Napa, Paralimni, Deryneia and Sotira Municipalities), ensuring a 48-hour water storage supply in the case of disruption to supply, while also providing an additional conveyor pipeline once the existing one is rehabilitated. The works include a 25km pipeline, 2 water storage tanks, a pumping station and chlorination building. The Contract on the delivery of the pipes and parts for the conveyor system was signed in 02/2024 and delivery will be completed in the end of October 2024. The tender for the construction of the water storage tanks and the chlorination building are expected to be announced in Q1 2025. This investment response to CSR 2020.3 Sub.5 and CSR 2019.4 Sub.3 as investment are being focus toward water management.

Funded by THALIA 2021-2027 Cohesion Policy – ERDF

Priority: A fair green and digital transition

44. E-Skills Action Plan: This reform includes (i) development of an e-skills policy framework and action plan, (ii) the design and delivery of targeted programmes for public sector professionals promoting cross-sectoral competencies, as well as (iii) the design of reskilling/upskilling interventions enhancing the digital literacy of the workforce in the private sector and unemployed persons, with a special focus on women and vulnerable groups. Furthermore, it entails a communication strategy to promote lifelong learning and a digital culture in Cyprus, investments in digital infrastructure to support digital learning and the development of an e-learning platform with key content material on digital skills and cross-sectoral competences accessible to all target groups. The implementation of this reform will be completed by the end of 2025. This reform responses to CSR 2020.3 Sub.7 and CSR 2019.4 Sub.4 as it enhances digital competences across all population groups.

Funded by RRF C5.1R5

Priority: A fair green and digital transition

45. Digital Transformation of School Units: This reform aims in enhancing digital skills and skills related to STEM education by transforming the curriculum and by upgrading the educational material. The procurement procedure for the transformation of the existing curricula of 120 content domains is

underway and the tender procedure for the development of the materials is expected to be announced in late October 2024. Moreover, the development of e-classes in 700 schools project has started and the schools have received equipment, which have been installed and are in full operation mode. Also, the financing for the acquisition of tablets by students has been completed successfully. This reform responds to CSR2020.3 Sub.7 and CSR 2019.4 Sub.4 as investments are focused towards digitization.

Funded by RRF C5.1R4

Priority: A fair green and digital transition

46. Aggressive Tax Planning: This reform aims to increase the effectiveness, efficiency and fairness of the tax system by combatting tax evasion and aggressive tax planning by Multinational Enterprises. The measure consists of three different reform sub-measures: (1) Imposing a withholding tax on outbound payments of interest, dividends and royalty payments and the introduction of a further corporate tax residency test based on the incorporation of each entity, (2) Introducing a withholding tax on outbound payments of interest, dividends and royalty payments to low tax jurisdictions. In respect of interest and royalty payments, the Cypriot authorities may explore instead the approach of applying non-deductibility. Such legislative change will enter into force by 31st of December 2024. The draft legislation is still pending, (3) Assess the effectiveness of the overall set of measures related to aggressive tax planning, via an independent evaluation that will be completed by 31st of December 2024. This evaluation will assess the Cyprus tax framework holistically including all measures adopted by then. The report is at its final stages and it is pending final submission by the Ministry of Finance. The evaluation shall lead to policy action to be undertaken by Cyprus to address any shortcomings identified, including in the form of legislative changes, which shall enter into force by 30th of June 2026. This reform responds to CSR 2020.4 Sub.1 and CSR 2019.1 Sub.4 as it addresses features of the tax system and especially aggressive tax planning.

Funded by RRF C3.5R10

Priority: Social and economic resilience

47. Digitalization of public services: The project is promoted through G-Cloud, Electronic Identity and Upgrade/Expansion of the Land Information System.

- The G-Cloud involves the development of a government cloud environment that will host the IT systems and digital services of various government departments and ministries. The G-Cloud will provide a secure, scalable, and efficient platform for the delivery of digital services, enabling the government to streamline operations, reduce costs, and improve service delivery to citizens. The initiative also includes the development of local data centers and the acquisition of consultancy services to support the implementation and management of the cloud environment. By centralizing and modernizing its IT infrastructure, the government aims to enhance the security and efficiency of its digital services, thereby improving the overall governance framework. It is included in the RRF C4.2R2.

- The Electronic Identity (eID) is a crucial component of Cyprus's digital transformation strategy and it aims to provide secure and efficient authentication methods for citizens accessing digital government services. By introducing electronic identities, the government seeks to enhance the development and use of digital services, making it easier for citizens to interact with the state and conduct transactions online. The eID initiative is expected to significantly boost the adoption of e-government services, improve the security of online transactions, and contribute to the overall digitalization of the public sector.
- Upgrade/Expansion of the Land Information System of the Department of Lands and Surveys. The objective of the Project is the set-up of an integrated modern Land Information System with updated, enhanced and redesigned functions, designed in an efficient manner, in order to serve efficiently, seamlessly and reliably the operational processes of the DLS as well as the provision of services to all independent services of the wider public sector, other organizations and to the citizens

These investments response to CSR 2020.4 Sub.3 as they promote the digitalization of public sector.

Funded by THALIA 2021-2027 Cohesion Policy- ERDF

Priority: A fair green and digital transition

48. Strategic development projects: This reform concerns the development of a new system supporting strategic development projects, aiming at stimulating developments in the country through streamlined rules and mechanisms, simplifying the licensing and permit procedures, reducing the administrative burden and making the strategic development environment more efficient. The relevant law entered into force on December 2023 and the secondary legislation for the implementation of the Law is pending for approval by the House of Representatives. This reform responses to CSR 2019.1 Sub.3 as key legislations for simplifying the procedures for strategic development projects are adopted to improve the efficiency in the public sector.

Funded by RRF C3.3R1

Priority: Social and economic resilience

49. Improving the effectiveness of the Department of Labour and Public Employment Services and reinforcing support for young people: This investment with a budget of €13,64 mln, will be completed by 30 June 2026 and consists of:

- A platform for digitalising the hiring schemes of the Department of Labour is being developed within the framework of the MoU signed between Cyprus and Austria in 19th of January 2023. Implementation of the project is according to the agreed timetable and the platform is expected to be completed by end of 2024.
- The Performance Management System for the Public Employment Services is being developed within the framework of the MoU signed between Cyprus and Austria in 19th of January 2023.

Currently, implementation is at the final phase and it is expected that the system control will start in October 2024. No delays are expected.

- The early warning and tracking system is being developed by the Department of Information Technology Services of the Deputy Ministry of Research, Innovation and Digital Policy. Progress is according to agreed timetable.
- A grant awarded to employers for hiring at least 600 young people not in employment or in education or training (NEETs) has started and 500 applications have been submitted.
- Coaching and career guidance for young people not in employment or in education or training (NEETs): the tender documents are under preparation.

This investment responds to CSR 2019.3 Sub 1 as it increases the effectiveness of the public employment services and reinforce outreach and activation support for young people by (i) safeguarding the successful implementation of employment schemes through digitalisation of their administration, (ii) improving the operational performance of the PES, (iii) minimising the risk for young persons not in employment, education or training (NEETs) to become long-term unemployed, (iv) supporting NEETs who are not yet registered with the PES by facilitating the integration of young registered unemployed in the labour market.

Funded by RRF C5.2I1

Priority: Social and economic resilience

50. Employment incentive scheme for young people aged 15 to 29 not in employment, education or training: This investment aims to mitigate unemployment among young people aged 15-29 years old who are not participating in an education or training programme and to sustainably integrate young people into the labour market by placing them in subsidised jobs. The grant is given for the first ten months of employment with an obligation of the employer to maintain the employee's employment for two additional months without a grant. The maximum grant amount is €8,600. The total budget of the Scheme is €15 mln, and three calls for proposals were launched. A total of 2297 applications were received and 2109 beneficiaries were included in the Scheme. The deadline for receiving applications was 21 of January 2022 and implementation is expected to be completed by the end of December 2024. This investment responds to CSR 2019.3 Sub 1, as it promotes the integration of young people in labour market.

Funded by THALIA 2021-2027, ESF+

Priority: Social and economic resilience

51. Transition of students with disabilities to Higher Education, including accessibility and support: Facilities are provided to students with disabilities for their transition to Higher Education, which include according to the disability, additional examination time, reading and simplifying the language formulation of the examination essay, spelling, punctuation and grammar free, exam essay explanation for candidates with hearing loss, clerk to faithfully copy the answer book of the candidates at the end of the examination and short breaks. The provision of facilities aims to ensure the statutory rights of persons with special needs

during the exams that the Cypriot students take for the entrance to public universities in Cyprus and Greece, as compensation for the disability or special problem they face, protects the inviolability of these exams, while it does not give preference to any candidate or group of candidates. This reform responds to CSR 2019.3 Sub 2, as it strengthens the reform of the education system in Cyprus, as well as promotes social inclusion.

Priority: Social and economic resilience

52. Pre-primary education from the age of four: This reform aims at the gradual extension of free compulsory pre-primary education from the age of four years old. By 30th of June 2026, the reform will provide free and compulsory pre-primary education to children as of the age of 4 years and 5 months and subsidise tuition fees for children between the age 4 years and 4 years and 5 months enrolled in private kindergartens. The cost for the full implementation of the extension, from September 2026 until June 2031, will be covered by national funds. The relative law was approved by the House of Representatives on 21st of March 2024 and was entered into force with its publication in the Official Gazette of the Republic on 26 of March 2024. This reform responds to CSR 2019.3 Sub.3 as it enhances the availability and affordability of early childhood education and care promoting the (re-)entry of people with childcare responsibilities, mostly women, into the labour market as well as children's educational outcomes and social inclusion.

Funded by RRF C5.1R3

Priority: Social and economic resilience

7.3 INVESTMENT NEEDS

Information with regards to investment needs that are promoted relating to the common priorities of the Union is listed below.

I. A fair green and digital transition, including consistency with the European Climate law

1. Cyprus phases many challenges towards green transition and in achieving the new targets of emission reduction from 24% to 32% by 2030 in ESR sectors, as well as more demanding targets for RES and energy efficiency. The way the new targets would be achieved as well as the necessary measures are set out in the revised Cyprus National Energy and Climate Plan (NECP), the final form of which will be submitted to the EU by December 2024. The implementation of these measures will require significant investments, both public and private amounting to €21.6 bln. It is noted that the majority concerns private investments mainly for clean vehicles and energy upgrades, estimated at €18 bln, while public expenditure is estimated at €3.6 bln. So far about €1 bln of public funds including from European funds has been allocated, while the remaining must be made available until 2030.
2. **Upgrade of the Integrated Financial Management System (FIMAS):** The Treasury of the Republic of Cyprus is upgrading its Integrated Financial Management System (FIMAS), which currently records governmental transactions and monitors the annual budget. This upgrade is pivotal for the

digitalization of public financial management processes. The new version will introduce features such as accruals accounting, Activity-Based Budgeting, enhanced economic and managerial reporting, and a redesigned Fixed Assets module. This will support decision-makers, the public, and stakeholders by providing timely and accurate information. Negotiations with the vendor are ongoing, with project initiation expected by November 2024.

3. **New e-Procurement System:** The new e-procurement system will revolutionize public procurement in Cyprus by incorporating new technologies, supporting data sharing between public entities, integrating additional services, and enabling statistical reporting. It will also enhance the user experience for economic operators, particularly SMEs, and ensure transparency by publishing open data on procurement procedures. The contract for this system was signed in January 2024, with full operationalization expected by the end of 2025. **Professionalization of Public Procurement:** To address inefficiencies in public procurement, Cyprus is implementing a professionalization scheme for procurers. This reform includes academic and practical certification and aims to create a skilled workforce capable of effectively managing procurement activities. The contract for this initiative, signed in 2022, is expected to conclude by September 2025.
4. **Energy Efficiency Upgrades in Public Hospitals:** By 2026, all public hospitals in Cyprus will undergo energy efficiency upgrades with national funds, including the installation of photovoltaic panels, contributing to the country's green transition goals.
5. **Immigration Policy Management / Digital reformation using RECAMAS:** The new Cyprus' IT system for Return Case Management (CIT-RECAMAS) will be interconnected to the existing databases/systems of Cyprus' Asylum Service (CASS) and of Civil Registry and Migration Department (ARS). Every person issued with a return decision (after a negative asylum decision, after a rejection of a legal migration application or after an apprehension as an illegal migrant) will be registered within CIT-RECAMAS and all data available in the three systems (CIT-RECAMAS, ARS, CASS) will be inter-linked. After the initial registration, all aspects of the return procedures will be managed through CIT-RECAMAS, including not only return decisions, detention and implementation of the return, but also return counselling, issuance of travel documents, identification missions, reintegration and all other necessary modules. It will be available to all national stakeholders and based on the needs of each authority and of the specific users, access to some of the modules will be given. This investment has a budget of €3.5 mln and it will be funded by national funds.

II. **Social and economic resilience, including the European Pillar of Social Rights**

1. **Improving the health System:** by measures including among others
 - (i) **Creation of a mobile Health Application for Cypriot Citizens** (myHealth@CY) funded by national funds.
 - (ii) **Development of a single bank of electronic files by the National e-Health Authority (NeHA).** This development aims at providing a single repository of healthcare data in Cyprus and making it available in a secure and reliable way to all entities. This investment will be funded by national funds.

- (iii) **Strengthening the national Health Technology Assessment** and successful implementation of Health Technology Assessment Regulation by Cyprus Authority by January 2025. A relevant requested will be submitted to DG Reform under the TSI 2025 Programme.

III. The build-up of defence capabilities

1. Expansion and upgrade of the existing Infrastructure Units such as:

- a. **Naval base Evangelos Florakis:** To bolster national naval defence capabilities and accommodate both national and partner naval assets, the MoD plans to expand and upgrade the Evangelos Florakis Naval Base. This project has been approved at the ministry level, and efforts are underway to secure EU funding schemes for co-financing the project.
- b. **Airforce Base Andreas Papandreou:** Similarly, to enhance national air defence capabilities and support both national and partner air assets, the Ministry of Defence is planning to expand and upgrade the Andreas Papandreou Airforce Base. This project has also been approved at the ministry level, with ongoing efforts to identify EU funding schemes for co-financing.

2. Development of Defence Capabilities through:

- a. **co-funding of Research and Development Joint European Projects (Participation in European Defence Fund (EDF) and European Defence Industrial Program):** The Ministry of Defence is participating in the European Defence Fund (EDF) and the European Defence Industrial Program, co-funding research and development projects that address both European and national defence needs. This initiative is ongoing, with the budget unofficially agreed upon with the Ministry of Finance.
- b. **Funding National Research & Development Projects in the Defence Domain:** To address national defence needs, the MoD is funding various national research and development projects. This initiative has been approved at the ministry level, and the budget has been unofficially agreed upon with the Ministry of Finance.

ANNEX 1: STATISTICAL TABLES

Table A1a. Fiscal commitments	2024	2025	2026	2027	2028
Commitments					
1. Net nationally financed primary expenditure (growth rate)	7,00	5,90	5,00	4,50	4,30
2. Net nationally financed primary expenditure (cumulative growth rate)	7,00	13,31	18,98	24,33	29,68

Table A1b. Main variables	2023	2024	2025	2026	2027	2028
1. Potential GDP	4,07	3,86	3,63	3,27	3,28	3,10
2. GDP deflator	2,47	3,66	3,14	3,24	3,26	2,98
3. Net lending/borrowing	3,33	3,94	2,73	2,55	2,06	2,11
4. Structural balance	2,03	2,74	1,77	1,61	1,13	1,24
5. Structural primary balance	3,40	4,16	3,34	3,06	2,53	2,44
6. Gross debt	77,42	68,90	64,15	58,82	53,26	47,39
7. Change in gross debt	-8,31	-8,51	-4,76	-5,33	-5,56	-5,87

Table A2. Macroeconomic scenario		2023 (Levels)	2023	2024	2025	2026	2027	2028
GDP								
1. Real GDP			2,47	3,66	3,14	3,24	3,26	2,98
2. GDP deflator			2,47	3,66	3,14	3,24	3,26	2,98
3. Nominal GDP	29,807		4,99	7,45	6,38	6,58	6,62	6,04
Components of real GDP								
4. Private consumption expenditure			4,25	3,40				
5. Government consumption expenditure			2,33	4,11				
6. Gross fixed capital formation			12,47	-5,72				
7. Changes in inventories and net acquisition of valuables (% of GDP)			0,00	0,00				
8. Exports of goods and services			-1,25	0,98				
9. Imports of goods and services			1,72	-1,75				
Contribution to real GDP growth								
10. Final domestic demand			5,51	1,61				
11. Changes in inventories and net acquisition of value			-0,19	0,00				
12. External balance of goods and services			-2,83	2,56				
Deflators and HICP								
13. Private consumption deflator			3,18	2,20				
14. p.m. HICP			3,90	2,20				
15. Government consumption deflator			8,26	6,00				
16. Investment deflator			2,83	2,03				
17. Export price deflator (goods and services)			2,16	2,20				
18. Import price deflator (goods and services)			0,54	1,60				

Labour market							
19. Domestic employment (1000 persons, national accounts)	474,2	1,49	2,10				
20. Average annual hours worked per person employed	1.830,8	0,25	0,20				
21. Real GDP per person employed		0,96	1,52	3,14	3,24	3,26	2,97
22. Real GDP per hour worked		0,71	1,33	3,14	3,24	3,26	2,97
23. Compensation of employees (bn NAC)	12233,7	7,42	7,07				
24. Compensation per employee (= 23 / 19)							
25. Unemployment rate (%)		5,80	5,00				
Potential GDP and components							
26. Potential GDP		4,07	3,86	3,63	3,27	3,28	3,10
27. Labour		1,62	1,37				
28. Capital		1,77	1,72				
29. Total factor productivity		0,69	0,77				
30. Output gap		2,58	2,38	1,89	1,87	1,84	1,72

Table A3. External assumptions	2023	2024	2025	2026	2027	2028
1. Short-term interest rate (% , annual average)	3,91	3,32	3,32	3,38	3,45	3,51
2. Long-term interest rate (% , annual average)	3,43	3,56	2,82	2,81	2,79	2,78
3. USD/EUR exchange rate (annual average)	1,08	1,07				
4. NAC/EUR exchange rate (only for non-EA Member States) (annual average)	-	-				
5. World real GDP (excluding EU) (growth rate)	3,60	3,50				
6. EU real GDP (growth rate)	0,40	1,00				
7. World import volumes, excluding EU (growth rate)	0,90	3,20				
8. Oil prices (Brent, USD/barrel)	82,50	85,40				

Table A4. Budgetary projections	2023 (Levels)	2023	2024	2025	2026	2027	2028
Revenue							
1. Taxes on production and imports	4,442	14,90	14,85				
2. Current taxes on income, wealth, etc	3,265	10,95	11,62				
3. Social contributions	3,590	12,05	13,06				
4. Other current revenue	1,317	4,42	4,58				
5. Capital taxes	0,000	0,00	0,00				
6. Other capital revenue	0,359	1,20	1,12				
7. Total revenue (= 1+2+3+4+5+6)	12,973	43,52	45,23				
8. Of which: Transfers from the EU (accrued revenue, not cash)	0,000	0,00	0,00				
9. Total revenue other than transfers from the EU (= 7-8)	12,973	43,52	45,23				
10. p.m. Revenue measures (increments, excluding EU funded measures)	-	-	-				

10b. p.m. Revenue reductions funded by transfers from the EU (levels)	-	-	-				
11. p.m. One-off revenue included in the projections (levels, excluding EU funded measures)	-	-	-				
Expenditure							
12. Compensation of employees	3,592	12,05	12,68				
13. Intermediate consumption	1,301	4,37	4,22				
14. Interest expenditure	0,407	1,37	1,42	1,57	1,45	1,40	1,20
15. Social benefits other than social transfers in kind	3,515	11,79	11,66				
16. Social transfers in kind via market producers	0,999	3,35	3,57				
17. Subsidies	0,161	0,54	0,38				
18. Other current expenditure	0,809	2,71	3,02				
19. Gross fixed capital formation	0,985	3,30	3,49				
20. Of which: Nationally financed public investment	0,000	0,00	0,00	0,00	0,00	0,00	0,00
21. Capital transfers	0,203	0,68	0,83				
22. Other capital expenditure	0,009	0,03	0,03				
23. Total expenditure (= 12+13+14+15+16+17+18+19+21+22)	11,981	40,19	41,29				
24. Of which: Expenditure funded by transfers from the EU (= 8-10b)	0,000	0,00	0,00				
25. Nationally financed expenditure (23-24)	11,981	40,19	41,29				
26. p.m. National co-financing of programmes funded by the Union	0,321	1,08	1,55				
27. p.m. Cyclical component of unemployment benefits	-0,023	-0,08	-0,03				
28. p.m. One-off expenditure included in the projections (levels, excluding EU funded measures)	0,000	0,00	0,00				
29. Net nationally financed primary expenditure (before revenue measures) (= 25-26-27-28-14)	11,276	37,83	38,35				
Net nationally financed primary expenditure							

30. Net nationally financed primary expenditure growth			7,00	5,90	5,00	4,50	4,30
Balances							
31. Net lending/borrowing (= 7-23)	0,992	3,33	3,94	2,73	2,55	2,06	2,11
32. Primary balance (= 31+14)	1,399	4,70	5,36	4,29	4,00	3,46	3,31
Cyclical adjustment							
33. Structural balance		2,03	2,74	1,77	1,61	1,13	1,24
34. Structural primary balance		3,40	4,16	3,34	3,06	2,53	2,44
Debt							
35. Gross debt	23,076	77,42	68,90	64,15	58,82	53,26	47,39
36. Change in gross debt	-0,737	-8,31	-8,51	-4,76	-5,33	-5,56	-5,87
37. Contributions to changes in gross debt							
38. Primary balance (= minus 32)		-4,70	-5,36	-4,29	-4,00	-3,46	-3,31
39. Snowball effect		-2,71	-3,94	-2,57	-2,52	-2,25	-1,83
40. Interest expenditure (= minus 14)		1,37	1,42	1,57	1,45	1,40	1,20
41. Growth		-2,01	-2,63	-2,03	-1,95	-1,80	-1,49
42. Inflation		-2,06	-2,73	-2,10	-2,01	-1,85	-1,54
43. Stock-flow adjustment (= 36-38-39)		-0,90	0,79	2,10	1,19	0,15	-0,73
44. p.m. Implicit interest rate on debt (= 14 / DEBT(t-1))		1,59	1,84	2,27	2,25	2,38	2,25

Table A5: Estimated impact of discretionary revenue measures

	Title/description measure	One-off	Exp / Rev	Sub-sector	ESA Code	2023	2024	2025	2026
						% GDP	% GDP	% GDP	% GDP
1	Reduction of the VAT rate (from 19% to 5%) on electricity consumption for the vulnerable consumers: Reduction of the VAT rate (from 19% to 5%) on electricity consumption for the vulnerable consumers, who are included in the special tariff 08 of the Electricity Authority of Cyprus, from November 2021 – August 2022	No	Revenue	0	D.2 - Taxes on production and imports	0.0	0.0		
2	Reduction of the VAT on the rest of consumers' electricity bills (from 19% to 9%): Reduction of the VAT rate (from 19% to 9%) on electricity consumption for the rest of the consumers, from November 2021 – August 2022	No	Revenue	0	D.2 - Taxes on production and imports	0.1	0.0		
3	Increased contribution rates in the context of the SSF: Increase in contribution rates as of 1st January 2019; further increase as of 1st January 2024 as per the related to the Social Security Contributions Law	No	Revenue	0	D.61 - Social contributions	0.0	0.5		
4	Reduction of excise duties on gasoline, diesel and on transport fuel: Reduction of excise duties on gasoline and diesel of 8.3 cents per litter for transport fuel and 6.4 cents per litter for heating fuel, in the context of the measures to compact the consequences of the high inflation rates.	No	Revenue	0	D.2 - Taxes on production and imports	0.0	0.1		

5	Zero/ reduced VAT rate in a number of goods/ services: From early-May 2023 until end-June 2024 (initially decided until end-October 2023, then until end-April 2024 and then until end June-2024), a zero VAT rate is applied on basic goods, and more specifically on bread, milk, eggs, baby foods, baby and adult diapers, as well as female hygiene products. Sugar and coffee were added to the list as of November 2023 as well as meat and vegetables as of December 2023	No	Revenue	0	D.2 - Taxes on production and imports	-0.1	0.0
6	Extension of the zero/ reduced VAT rate in a number of goods/ services: During the budgetary process, the extension of the reduced VAT rate in a number of goods/ services was decided until end-September 2024	No	Revenue	0	D.2 - Taxes on production and imports	0.0	0.0
7	Civil Servants New Pension Scheme, government contribution as employer: Civil Servants Pension Scheme is based on a Law of 2022 which Benefits Civil Service Employees and the broader Public Sector (including Municipalities and Community Boards) and it is in force since 1/1/2023. Members of the Scheme are employees (permanent or indefinite time) serving since 10/2011. The employer and the employee pay a corresponding amount on both sides at a rate equal to 5% of the member's monthly pensionable benefits. The payment of the amounts specified begins on the day that the employee becomes a member of the Plan and ends with his/her retirement from the state service or the broader Public Sector.	No	Revenue	0	D.61 - Social contributions	0.1	0.0

8	<p>Civil Servants New Pension Scheme, employees' contribution: Civil Servants Pension Scheme is based on a Law of 2022 which Benefits Civil Service Employees and the broader Public Sector (including Municipalities and Community Boards) and it is in force since 1/1/2023. Members of the Scheme are employees (permanent or indefinite time) serving since 10/2011. The employer and the employee pay a corresponding amount on both sides at a rate equal to 5% of the member's monthly pensionable benefits. The payment of the amounts specified begins on the day that the employee becomes a member of the Plan and ends with his/her retirement from the state service or the broader Public Sector.</p>	No	Revenue	0	D.61 - Social contributions	0.1	0.0
9	<p>Civil servants pension scheme retroactive payments: Civil Servants Pension Scheme is based on a Law of 2022 which Benefits Civil Service Employees and the broader Public Sector (including Municipalities and Community Boards) and it is in force since 1/1/2023. The retroactive payments covering the years before 2023 will take place during 2024-2026.</p>	No	Revenue	0	D.61 - Social contributions	0.0	0.4
10	<p>Abolition of the Annual Levy of Companies: Abolition of the Annual Levy of €350 payable to the Registrar of Companies and Intellectual Property by all registered entities</p>	No	Revenue	0	D.5 - Current taxes on income, wealth, etc	0.0	-0.1
11	<p>Defence levy on interest receivable: Reduction of the extraordinary defence levy on interest receivable from 30% to 17%.</p>	No	Revenue	0	D.5 - Current taxes on income, wealth, etc	0.0	0.0

12	Methodological treatment of the non-indexation of personal income tax brackets: Methodological treatment in order to adjust the personal income tax brackets to the inflation rate. The difference between the non-indexation and the hypothetical full annual indexation at the inflation rate is recorded as a revenue increasing measure.	No	Revenue	0	D.5 - Current taxes on income, wealth, etc	0.0	0.1	
	TOTAL					0.3	0.9	

Table A7a. Debt and headline balance projections and key underlying assumptions (under the planned fiscal path)

	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034	2035	2036	2037	2038
1. Gross debt	77,42	68,90	64,15	58,82	53,26	47,39	44,30	41,50	39,10	36,80	34,90	33,20	31,60	30,30	29,00	27,90
2. General government balance	3,33	3,94	2,73	2,55	2,06	2,11	2,20	2,00	1,80	1,60	1,40	1,30	1,10	1,00	0,90	0,80
3. Structural primary balance	3,40	4,16	3,34	3,06	2,53	2,44	2,40	2,40	2,40	2,40	2,40	2,40	2,40	2,40	2,40	2,40
4. Cyclical component	-1,30	-1,20	-1,00	-0,90	-0,90	-0,90	-0,90	-0,90	-0,90	-0,90	-0,90	-0,90	-0,90	-0,90	-0,90	-0,90
5. One-off measures	0,00	0,00	1,95	1,84	1,83	1,77	2,00	1,70	1,50	1,20	1,00	0,90	0,60	0,50	0,30	0,20
6. Interest expenditure	1,37	1,42	1,57	1,45	1,40	1,20	1,30	1,20	1,20	1,10	1,10	1,10	1,00	1,00	0,90	0,90
7. Long-term interest rate	2,43	2,43	2,46	2,45	2,45	2,45	3,60	3,60	3,70	3,80	3,80	3,90	3,90	3,90	3,90	3,90
8. Short-term interest rate	3,43	3,56	2,82	2,70	2,50	2,30	2,80	2,80	2,70	2,70	2,70	2,70	2,70	2,60	2,60	2,50
9. Implicit average interest rate	1,59	1,84	2,27	2,25	2,38	2,25	2,86	2,82	3,01	2,93	3,11	3,28	3,14	3,30	3,10	3,24
10. Stock-flow adjustment	-0,90	0,79	2,10	1,19	0,15	-0,73	0,90	0,90	0,90	0,90	0,90	0,90	0,90	0,90	0,90	0,90
11. Potential GDP	4,07	3,86	3,63	3,27	3,28	3,10	1,70	1,60	1,50	1,50	1,50	1,50	1,60	1,70	1,80	1,80
12. Real GDP	2,47	3,66	3,14	3,24	3,26	2,98	1,70	1,60	1,50	1,50	1,50	1,50	1,60	1,70	1,80	1,80
13. GDP deflator	2,47	3,66	3,14	3,24	3,26	2,98	2,50	2,50	2,50	2,50	2,60	2,50	2,50	2,50	2,40	2,40
14. Nominal GDP	4,99	7,45	6,38	6,58	6,62	6,04	4,24	4,14	4,04	4,04	4,14	4,04	4,14	4,24	4,24	4,24

Table A7b. Debt projections and key stressed variables, deterministic scenarios and stochastic simulations

	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034	2035	2036	2037	2038
Financial stress scenario																
1. Gross debt	77,42	68,90	64,20	58,80	53,30	47,50	44,30	41,60	39,10	37,00	35,10	33,30	31,80	30,50	29,20	28,10
2. Long-term interest rate	2,43	2,43	2,46	2,45	2,45	2,45	4,60	3,60	3,70	3,80	3,80	3,90	3,90	3,90	3,90	3,90
3. Short-term interest rate	3,43	3,56	2,82	2,70	2,50	2,30	3,80	2,80	2,70	2,70	2,70	2,70	2,70	2,60	2,60	2,50
Lower SPB scenario																
4. Gross debt	77,42	68,90	64,20	58,80	53,30	47,50	44,40	42,40	41,00	40,10	39,70	39,30	39,10	39,10	39,20	39,50
5. Structural primary balance	3,40	4,16	3,30	3,10	2,50	2,40	2,20	1,90	1,90	1,90	1,90	1,90	1,90	1,90	1,90	1,90
Adverse 'r-g' scenario																
6. Gross debt	77,42	68,90	64,20	58,80	53,30	47,50	44,60	42,00	39,80	37,80	36,20	34,60	33,40	32,20	31,20	30,30
7. Long-term interest rate	2,43	2,43	2,46	2,45	2,45	2,45	4,10	4,10	4,20	4,30	4,30	4,40	4,40	4,40	4,40	4,40
8. Short-term interest rate	3,43	3,56	2,82	2,70	2,50	2,30	3,30	3,30	3,20	3,20	3,20	3,20	3,20	3,10	3,10	3,00
9. Real GDP	2,47	3,66	3,10	3,20	3,30	3,00	1,20	1,10	1,00	1,00	1,00	1,00	1,10	1,20	1,30	1,30
10. Potential GDP	4,07	3,86	3,63	3,27	3,28	3,10	1,20	1,10	1,00	1,00	1,00	1,00	1,10	1,20	1,30	1,30
Stochastic simulations																
11. Probability of debt being below its value in T+4/7	80,7															

Table A7c. Debt and headline balance projections and underlying assumptions (under 'no-fiscal-policy-change' baseline)

	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034	2035	2036	2037	2038
1. Gross debt	77,42	68,90	64,20	58,80	53,30	47,50	45,20	43,40	41,90	40,60	39,60	38,80	38,20	37,70	37,40	37,20
2. General government balance	3,33	3,94	2,70	2,50	2,00	2,10	1,20	1,00	0,70	0,60	0,30	0,20	0,00	-0,20	-0,30	-0,40
3. Structural primary balance	3,40	4,16	3,30	3,10	2,50	2,40	2,40	2,40	2,40	2,40	2,40	2,40	2,40	2,40	2,40	2,40
4. Cyclical component	-1,30	-1,20	-1,00	-0,90	-0,90	-0,90	-0,90	-0,90	-0,90	-0,90	-0,90	-0,90	-0,90	-0,90	-0,90	-0,90
5. Interest expenditure	1,37	1,42	1,60	1,40	1,40	1,20	1,30	1,30	1,20	1,20	1,20	1,20	1,20	1,20	1,20	1,20
6. Long-term interest rate	2,43	2,43	2,46	2,45	2,45	2,45	3,60	3,60	3,70	3,80	3,80	3,90	3,90	3,90	3,90	3,90
7. Short-term interest rate	3,43	3,56	2,82	2,70	2,50	2,30	2,80	2,80	2,70	2,70	2,70	2,70	2,70	2,60	2,60	2,50
8. Implicit average interest rate	1,67	1,97	2,40	2,25	2,46	2,32	2,81	2,95	2,83	2,94	3,03	3,11	3,17	3,22	3,26	3,29
9. Potential GDP	4,07	3,86	3,63	3,27	3,28	3,10	1,70	1,60	1,50	1,50	1,50	1,50	1,60	1,70	1,80	1,80
10. Real GDP	2,47	3,66	3,10	3,20	3,30	3,00	1,70	1,60	1,50	1,50	1,50	1,50	1,60	1,70	1,80	1,80
11. GDP deflator	2,47	3,66	3,14	3,24	3,26	2,98	2,50	2,50	2,50	2,50	2,60	2,50	2,50	2,50	2,40	2,40
12. Nominal GDP	4,99	7,45	6,34	6,54	6,66	6,06	4,24	4,14	4,04	4,04	4,14	4,04	4,14	4,24	4,24	4,24
13. Fiscal multiplier	0,75															

Table A9: Other reforms and investments

		RRF / PA	CSR	Common priorities
1	Submission of Medium term Fiscal Structural Plan		2024.1 Sub.1	Social and economic resilience
2	Revision and Update of Cyprus National Strategy on Adaptation to Climate Change	THALIA 2021-2027 Cohesion Policy – Cohesion Fund	2024.2 Sub.1	A fair green and digital transition
3	Governance framework of the State-Owned Entities		2024.3 Sub.1	Social and economic resilience
4	Addressing skills mismatch between education and labour market (Secondary and Higher Education)	RRF – C5.1R1	2024.3 Sub.2	Social and economic resilience
5	New system of evaluation of the educational work and the educators	RRF – C5.1R2	2024.3 Sub.2	Social and economic resilience
6	Teachers’ professional learning		2024.3 Sub.2	Social and economic resilience
7	Development of Technical Vocational Education and Training	THALIA 2021-2027 Cohesion Policy – ESF+	2024.3 Sub.2	Social and economic resilience
8	VET Strategy		2024.3 sub 2	Social and economic resilience
9	VET school in Larnaca	THALIA 2021-2027, JTF	2024.3 sub 2	Social and economic resilience
10	Actions for School and Social Inclusion+ (DRA.S.E.+)	THALIA 2021-2027 ESF+	2024.3 Sub 2	Social and economic resilience
11	Cyprus Lifelong Learning Strategy (CyLLLS) for the years 2021-2027		2024.3 Sub.2	Social and economic resilience
12	Training programmes for young people aged 15-29 not in education, employment, or training (NEETs)	THALIA 2021-2027 Cohesion Policy – ESF+	2024.3 Sub.2	Social and economic resilience

13	Individual Learning Accounts (ILAs)	THALIA 2021-2027 Cohesion Policy 2024.3 – ESF+	Social and economic resilience
14	GIS to support the digital transformation of networks, the transition to green energy	THALIA 2021-2027 Cohesion Policy 2024.4 - JTF	Energy security
15	Digitization of Distribution System and development of a SCADA/ADMS system for the monitoring and control of the system	THALIA 2021-2027 Cohesion Policy 2024.4 - JTF	Energy security
16	Development of a Fiber Optic Telecoms Network to Support the Demanding Communication Needs of the Distribution System in the Energy Transition	THALIA 2021-2027 Cohesion Policy 2024.4 - JTF	Energy security
17	Mass installation and operation by the Distribution System Operator (DSO) of Smart Metering Infrastructure (Advanced Metering Infrastructure)	RRF – C2.1I7	2024.4 A fair green and digital transition
18	Guidance Documents for Renewable Energy Sources (RES) applications	RRF – C2.1R3 THALIA 2021-2027 Cohesion Fund - JTF	2024.4 Energy security
19	Support Schemes for Energy Storage	THALIA 2021-2027 Cohesion Policy- JTF	2024.4 Energy security
20	Provision of Environmental Incentives in maritime transport		2023.4 A fair green and digital transition
21	Grant Scheme for the encouragement of the use of RES	RRF – C2.1I2	2023.4 A fair green and digital transition
22	Electricity interconnection between Cyprus - Greece - Israel (Great Sea Interconnector)	RRF – C2.1I11	2023.4 Energy security
23	Saving – Upgrading Houses Programme	RRF - C2.1I5, THALIA 2021-2027 Cohesion Policy- Sub.4	2023.4 A fair green and digital transition
24	PEDIA Project	ERDF and National Funds THALIA 2021-2027 Cohesion Policy 2023.4 - ERDF	2023.4 A fair green and digital transition
25	Promote widespread use of Electric Vehicles (EVs)	RRF – C2.2I3	2023.4 A fair green and digital transition
26	Installation of publicly accessible EVcharging points	RRF – C2.2I2	2023.4 A fair green and digital transition

27	Digital One-Stop Shops to streamline RES projects permitting and to facilitate Energy Renovation in Buildings	RRF - C2.1R3	2022.4 Sub.3	A fair green and digital transition
28	Infrastructure Projects on Sustainable Urban Mobilities Plans	RRF C2.2I1 and THALIA 2021-2027 Cohesion Policy – ERDF	2022.4 Sub.6	A fair green and digital transition
29	Enhancement, modernization and upgrade of Cyprus Public Hospitals	RRF – C1.1I5	2020.1 Sub.2	Social and economic resilience
30	Establishment of Home structures for children, adolescent with conduct disorders and persons with disabilities and people in need of long-term care (LTC)	RRF - C5.2I3	2020.1. Sub 2	Social and economic resilience
31	Minimum Guaranteed Income (GMI)	THALIA 2021-2027 Cohesion Policy – ESF+	2020.2 Sub.1	Social and economic resilience
32	Information and Training Centre for Employment and Entrepreneurial Action in Vulnerable Groups	THALIA 2021-2027 Cohesion Policy- ERFD	2020.2 Sub.1	Social and economic resilience
33	Digitalization of services of PES	RRF – C5.2I1	2020.2 Sub.2	Social and economic resilience
34	Outreach Activities for NEETs aged 15-29 with the development of four mobile unit of PES	THALIA 2021 - 2027 - ESF	2020.2 Sub.2	Social and economic resilience
35	Subsidy schemes of employment /including flexible work arrangements	THALIA 2021-2027 Cohesion Policy – ESF+	2020.2 Sub.3	Social and economic resilience
36	Training programmes for the acquisition of digital, green, blue and entrepreneurship skills	RRF – C5.1I2	2020.2 Sub.4	Social and economic resilience
37	National Promotional Agency (NPA)	RRF – C3.3R4	2020.3 Sub.1	Social and economic resilience
38	Cyprus Equity Fund	RRF – C3.3I6	2020.3 Sub.1	Social and economic resilience
39	Municipal waste Management Plan	RRF - C3.1I12 and THALIA 2021-2027 Cohesion Policy	2020.3 Sub.5	A fair green and digital transition
40	Implementation of a Nationwide system for the separate collection of municipal waste	THALIA 2021 –2027 Cohesion Policy	2020.3 Sub.5	A fair green and digital transition

41	National Circular Economy Action Plan	Partly THALIA 2021-2027 Cohesion Policy	2020.3 Sub.5	A fair green and digital transition
42	Water Treatment Plants	RRF – C2.3I2	2020.3 Sub.5	A fair green and digital transition
43	Kokkinokremmos Conveyor Project	THALIA 2021-2027 Cohesion Policy - ERDF	2020.3 Sub.5	A fair green and digital transition
44	E-Skills Action Plan	RRF – C5.1R5	2020.3 Sub.7	A fair green and digital transition
45	Digital Transformation of school units	RRF – C5.1R4	2020.3 Sub.7	A fair green and digital transition
46	Aggressive tax planning reform	RRF - C3.5R10	2020.4 Sub.1	Social and economic resilience
47	Digitalization of public services	RRF – THALIA 2021 – 2027 Cohesion Policy - ERDF	2020.4 Sub.3	A fair green and digital transition
48	Strategic Development Projects	RRF – C3.3R1	2019.1 Sub.3	Social and economic resilience
49	Improving the effectiveness of the Department of Labour and Public Employment Services and reinforcing support for young people	RRF - C5.2I1	2019.3 Sub 1	Social and economic resilience
50	Transition of students with disabilities to Higher Education, including accessibility and support	THALIA 2021-2027 ESF+	2019.3 Sub 2	Social and economic resilience
51	Employment incentive scheme for young people aged 15 to 29 not in employment, education or training		2019.3 Sub 2	Social and economic resilience
52	Pre-primary education from the age of four	RRF - C5.1R3	2019.3 Sub.3	Social and economic resilience

Table A10: Investment needs

Common priorities		Description of investment needs
1	A fair green and digital transition, including consistency with the European Climate Law	<p>1. Investment needs for the implementation of the national energy and Climate Plan for green transition measures.</p> <p>2. Upgrade of the Intergrated Financial Management System (FIMAS) of the Treasury of the Republic of Cyprus</p> <p>3. New e-procurement system: Professionalization of Public Procurement in Cyprus</p> <p>4. Energy efficiency upgrading of Public Hospital Buildings and installation of photovoltaic panels across all Public Hospitals, by 2026.</p> <p>5. Immigration Policy Management</p>
2	Social and economic resilience, including the European Pillar of Social Rights	<p>1. Improving the health System by measures including among others</p> <ul style="list-style-type: none"> (i) Creation of a mobile Health Application for Cypriot Citizens (myHealth@CY) (ii) Development of a single bank of electronic files by the National e-Health Authority (NeHA) (iii) Strengthening the national Health Technology Assessment
3	Energy security	-
4	Where necessary, the build-up of defense capabilities	<p>1. Expansion and upgrade of the existing Infrastructure Units such as:</p> <ul style="list-style-type: none"> (i) Naval base Evangelos Florakis (ii) Airforce Base Andreas Papandreou

ANNEX 2: IFI OPINION



ΚΥΠΡΙΑΚΗ ΔΗΜΟΚΡΑΤΙΑ

Αρ. Εγγράφου: 1150

30 Σεπτεμβρίου 2024

Προς
Υπουργό Οικονομικών
κ. Μάκη Κεραυνό

Θέμα: Μακροοικονομικές και δημοσιονομικές προβλέψεις στα πλαίσια του Προϋπολογισμού του 2025

Αξιότιμε Κύριε Υπουργέ,

Αναφέρομαι στην επιστολή σας με το πιο πάνω θέμα, ημερομηνίας 17.09.24 και Αρ.Φακ. Υ.Ο.13.24.009.003 και επιθυμώ να σας ενημερώσω πως, με απόφασή του ημερ. 24.09.2024, το Δημοσιονομικό Συμβούλιο Κύπρου (ΔΣΚ) επικυρώνει τις παραδοχές βάσει των οποίων ετοιμάστηκε ο Προϋπολογισμός 2025 και ΜΔΠ 2025-2027, θεωρώντας πως αυτές βρίσκονται εντός της σφαίρας των ρεαλιστικών σεναρίων.

Επιπλέον, σημειώνουμε πως, βάσει των στοιχείων του προσχεδίου του Προϋπολογισμού 2025 και ΜΔΠ 2025-2027, η οροφή των πρωτογενών καθαρών δαπανών της Δημοκρατίας για την επόμενη τριετία, εκ πρώτης όψεως παραμένει εντός του Ορίου Αναφοράς όπως αυτό προκύπτει κάτω από το νέο Πλαίσιο Οικονομικής Διακυβέρνησης. Ως αποτέλεσμα, η δημοσιονομική πορεία της χώρας, όπως αυτή καταγράφεται στο προσχέδιο του Προϋπολογισμού 2025, βρίσκεται εντός των υποχρεώσεων της Δημοκρατίας.

Σημειώνουμε παράλληλα, πως ο σχεδιασμός, βάσει του οποίου ο ρυθμός αύξησης των καθαρών πρωτογενών δαπανών παραμένει κατά μέσο όρο χαμηλότερα από το Όριο Αναφοράς (μ.ο. 2025-2028 στο 4,95%), προσδίδει την ευκαιρία στη Δημοκρατία να αντιμετωπίσει νέες δαπάνες οι οποίες δεν προβλέπονται στο υφιστάμενο πλαίσιο του προϋπολογισμού, αλλά είναι πολύ πιθανόν να προκύψουν στην συνέχεια. οι εν λόγω δαπάνες, για τις οποίες το ΔΣΚ εξέφρασε κατ' επανάληψη ανησυχία, αναμένεται πως θα διαμορφωθούν μεταγενέστερα του 2025. Είναι, επομένως λιγότερο ανησυχητικές ως δυνητικό αίτιο εκτροχιασμού των δημοσίων οικονομικών, εφ' όσον υφίσταται δημοσιονομικός χώρος για τουλάχιστον μερική κάλυψή τους χωρίς να τεθεί η χώρα εκτός των υποχρεώσεων της.

Ωστόσο, επισημαίνεται πως ο δημοσιονομικός σχεδιασμός βάσει του Προϋπολογισμού 2025 και ΜΔΠ 2025-2027, ολοκληρώνεται το 2027, ένα χρόνο νωρίτερα από το Όριο Αναφοράς και σας υποβάλλουμε την εισήγηση πως, στο εξής, οι Κρατικοί Προϋπολογισμοί και Μεσοπρόθεσμα Δημοσιονομικά Πλαίσια θα πρέπει να έχουν τετραετή δεσμευτικό ορίζοντα και όχι τριετή, με σκοπό να συνάδουν με τους νέους δημοσιονομικούς κανόνες διακυβέρνησης της ΕΕ.

Σημαντική διαπίστωση είναι πως ο υφιστάμενος σχεδιασμός προβλέπει συγκράτηση των δαπανών μισθολογίου της Δημοκρατίας, αλλά και γενικότερα συγκράτηση των ανελαστικών δαπανών με ορίζοντα το

2027. Παρόλο ότι οι εν λόγω δαπάνες συνεχίζουν να καταγράφουν αυξήσεις, και στην περίπτωση του μισθολογίου, οι αυξήσεις είναι μεγαλύτερες από την αύξηση των εσόδων, εντούτοις σημειώνουμε πως καταγράφεται, τουλάχιστον, επιβράδυνση, κάτι που υπονοεί πως βρίσκεται υπό ανάπτυξη ή υπάρχει πρόθεση για ανάπτυξη σχετικής πολιτικής.

Πρέπει, όμως, να σημειωθεί η σημαντική επιβράδυνση των αναπτυξιακών δαπανών όπως παρουσιάζεται για το 2027, οπότε και αναμένεται να ολοκληρωθεί σειρά από προγραμματισμένα έργα δημοσίων επενδύσεων, κάτι που θα επηρεάσει και τις αναπτυξιακές προοπτικές της οικονομίας.

Περαιτέρω παρατηρείται πως, με την επιβράδυνση των δαπανών το 2027, κατά την περίοδο 2027-2028, δημιουργείται δημοσιονομικός χώρος για αύξηση άλλων δαπανών κάτω από τους νέους Κανόνες Οικονομικής Διακυβέρνησης της ΕΕ. Αυτός ο χώρος μεταφράζεται σε μεγάλο πειρασμό για αποφάσεις με πρωτίστως πολιτικά κριτήρια, οι οποίες σχετίζονται με την ολοκλήρωση του εκλογικού κύκλου εν όψει προεδρικών εκλογών, με αποτέλεσμα να είναι αυξημένος ο ηθικός κίνδυνος για αποφάσεις δαπανών που δεν θα είναι βέλτιστες για τα δημόσια οικονομικά. Η ανησυχία για την λήψη μη βέλτιστων αποφάσεων εν μέσω προεκλογικής περιόδου, δεν αποτελεί πολιτικό σχόλιο κατά της σημερινής διακυβέρνησης, καθώς η πολιτική πίεση ενδέχεται να προέλθει από οποιονδήποτε κόμβο πολιτικής ηγεσίας. Η διάρθρωση των δαπανών, σε κάθε περίπτωση, ενθαρρύνει τέτοια πολιτική πίεση, κάτι το οποίο επιθυμούμε να θέσουμε υπόψη σας.

Λόγω της καθυστερημένης εξασφάλισης των στοιχείων του Προϋπολογισμού από το Υπουργείο Οικονομικών προς το ΔΣΚ, επιπλέον επί μέρους ποιοτική ανάλυση δεν είναι δυνατή τη δεδομένη στιγμή και το ΔΣΚ επιφυλάσσεται να επανέλθει σε σχέση με την τελική επίτευξη των δημοσιονομικών στόχων, βάσει των νέων Κανόνων Οικονομικής Διακυβέρνησης της ΕΕ, αλλά και σε σχέση με την διάρθρωση των εσόδων και δαπανών.

Με απόφαση του ημερ. 24.09.2024, το Συμβούλιο εκφράζει, δε, την ανησυχία του για την καθυστερημένη πρόσβαση του στα σχετικά στοιχεία, πέρα από τον απλό πίνακα των μακροσκοπικών παραδοχών. Όπως έχουμε σημειώσει και παλαιότερα, ολοκληρωμένη επικύρωση των παραδοχών δεν μπορεί να πραγματοποιηθεί στην απουσία ενημέρωσης για τον δημοσιονομικό σχεδιασμό και επομένως η καθυστέρηση στην πρόσβαση στα σχετικά στοιχεία, αποτελεί σημαντικό εμπόδιο στην εργασία του ΔΣΚ. Επιπλέον, δεν δόθηκε χρόνος στο ΔΣΚ για επικύρωση των παραδοχών πριν την υποβολή του Προσχεδίου του Προϋπολογισμού 2025 στο Υπουργικό Συμβούλιο.

Εκφράζουμε, περαιτέρω, την απογοήτευση μας για το γεγονός ότι η πληροφόρηση που δόθηκε στον Τύπο ήταν πιο έγκαιρη και ολοκληρωμένη από την πληροφόρηση που αργότερα δόθηκε στο ΔΣΚ. Θεωρούμε ανορθόδοξη την πρακτική να ενημερώνεται ο Τύπος νωρίτερα και πιο ολοκληρωμένα από τους θεσμούς της Δημοκρατίας μας.

Όπως σημειώνουμε και πιο πάνω, επιφυλασσόμαστε για πιο ολοκληρωμένη ποιοτική και ποσοτική ανάλυση των θεμάτων της αρμοδιότητάς μας, βάσει της πλήρους ενημέρωσης και της ανταλλαγής στοιχείων στο επόμενο διάστημα.

Σε κάθε περίπτωση, όμως, εκφράζουμε την ικανοποίησή μας για την δημοσιονομική πορεία όπως αυτή διαγράφεται στο Προσχέδιο του Προϋπολογισμού 2025, καθώς και για το γεγονός ότι ο δημοσιονομικός σχεδιασμός παραμένει με άνεση εντός των υποχρεώσεων της Κύπρου, βάσει των νέων κανόνων που αποφασίστηκαν σε ευρωπαϊκό επίπεδο. Ωστόσο, η μείωση δαπανών σε συγκεκριμένες κατηγορίες, όπως η Αστυνόμευση, οι μεταβιβάσεις εσωτερικού (σε ημικρατικούς και σε Επιτροπές/Οργανώσεις/Συμβούλια) και οι λειτουργικές δαπάνες, δεν συνοδεύονται, βάσει των στοιχείων που έχουμε σήμερα στη διάθεσή μας, από παράλληλες πολιτικές αποφάσεις. Δεν είναι, επομένως, ξεκάθαρο κατά πόσον αυτές οι μειώσεις, οι οποίες ενέχουν και υψηλό πολιτικό ρίσκο υλοποίησης στην περίπτωση μεταβιβάσεων εσωτερικού, θα μπορέσουν να υλοποιηθούν ως έχει προγραμματιστεί στον Προϋπολογισμό 2025 και ΜΔΠ 2025-2027.

Παρά την θετική πορεία σε επίπεδο οροφών στις δαπάνες, οι Πορείες Αναφοράς σε σχέση με το δημοσιονομικό έλλειμμα και το δημόσιο χρέος, όπως αυτές εμφανίζονται στο Προσχέδιο του Προϋπολογισμού 2025, βρίσκονται υψηλότερα -αλλά κοντά- στην πορεία που προκύπτει κάτω από τους νέους δημοσιονομικούς κανόνες. Έτσι, δεν εγείρεται σοβαρή ανησυχία και το ρίσκο δημοσιονομικού εκτροχιασμού στο βραχύ διάστημα κρίνεται ως χαμηλό.

Ανάπτυξη

Σε σχέση με την μακροοικονομική προοπτική, η ανάπτυξη συνεχίζει να καταγράφει σημαντική επιτάχυνση κατά το α' εξάμηνο του τρέχοντος έτους, και παρά το ότι αναμένεται μερική ομαλοποίησή της, με αποτέλεσμα ο τελικός ρυθμός ανάπτυξης είναι κατά πάσα πιθανότητα χαμηλότερος του προβλεπόμενου 3.7%, η δυναμική ανάπτυξης παραμένει αυξημένη. Σημειώνουμε πως, κάτω από τα σενάρια με τα οποία ο ρυθμός ανάπτυξης θα είναι, τελικά, χαμηλότερος των παραδοχών και εντός του φάσματος 3.3% με 3.5%, οι υποθέσεις εργασίας για τα κρατικά έσοδα δεν επηρεάζονται σε μεγάλο βαθμό. Η πιο συντηρητική υπόθεση για την ανάπτυξη, δεν έχει δημοσιονομικό αντίκτυπο στις εκτιμήσεις για τα επόμενα έτη, λόγω της επίδρασης άλλων, εξωγενών, μεταβλητών, όπως είναι η μείωση του Φορολογικού Κενού, την οποία παρατηρήσαμε και καταγράψαμε στην Ενδιάμεση Έκθεση 2024 του ΔΣΚ. Ελαφρώς αισιόδοξες ενδεχομένως να αποδειχθούν, επίσης, και οι παραδοχές για την ανάπτυξη των ετών 2026 και 2027.

Σημειώνουμε πως σημαντική συμβολή στις εκτιμήσεις για την ανάπτυξη, διαδραματίζει η επιτάχυνση των εξαγωγών και δη των εξαγωγών τεχνολογίας. Η εικόνα που παρουσιάζεται ενισχύει τις ανησυχίες μας για την ελλιπή συλλογή στοιχείων που σχετίζονται με την εισροή ξένων επενδύσεων για την οποία, σύμφωνα με πολλές ενδείξεις, είναι αυξημένος ο κίνδυνος απότομης εξόδου κάτω από προϋποθέσεις οι οποίες, στην απουσία στοιχείων και πολιτικής, παραμένουν εξολοκλήρου εξωγενείς, χωρίς οποιονδήποτε έλεγχο από πλευράς της Δημοκρατίας.

Πληθωρισμός

Όσον αφορά στην εκτίμηση για επαναφορά των ρυθμών πληθωρισμού στο 2%, παρατηρούμε πως η γενικότερη εικόνα του Εναρμονισμένου Δείκτη Τιμών Καταναλωτή, σε συνδυασμό και με την ευρύτερη εικόνα που επικρατεί στη ζώνη του Ευρώ (περιλαμβανομένης και της νομισματικής πολιτικής), είναι δικαιολογημένη. Καταγράφουμε όμως την έντονη διαφοροποίηση στον ρυθμό αύξησης των τιμών, μεταξύ εγχώριων και εισαγόμενων προϊόντων και υπηρεσιών.

Η συγκράτηση των ρυθμών του πληθωρισμού φαίνεται να οφείλεται σχεδόν αποκλειστικά στην μείωση των τιμών εισαγόμενων προϊόντων (περιλαμβανομένων των καυσίμων, της ενέργειας, των υπηρεσιών, των τροφίμων αλλά και των βιομηχανικών προϊόντων). Αντίθετα, παρατηρούμε συνεχιζόμενη διάχυση των αυξήσεων στις τιμές των εγχώριων προϊόντων και υπηρεσιών. Αυτή η διττή εικόνα δικαιολογεί και την απόκλιση των εντυπώσεων που επικρατούν σε ότι αφορά με το κόστος ζωής, σε σχέση με τους επίσημους ρυθμούς πληθωρισμού.

Ιδίως όσον αφορά στις μη εμπορεύσιμες υπηρεσίες, η διάχυση των αυξήσεων στις τιμές συνεχίζεται ακόμα και δεν διαφαίνονται ενδείξεις επιβράδυνσης. Παρά το γεγονός ότι τα επίπεδα τιμών σε σημαντικές κατηγορίες, όπως είναι η υγεία και η παιδεία, έχουν θωρακιστεί από κρατικές πολιτικές, όπως είναι το ΓεΣΥ, άλλες κατηγορίες συνεχίζουν να σημειώνουν ρυθμούς αύξησης των τιμών υπερδιπλάσιους του Γενικού Δείκτη Τιμών Καταναλωτή.

Αυτές περιλαμβάνουν υπηρεσίες κοινωνικής προστασίας, υπηρεσίες συντήρησης οικίας και άλλες μη εμπορεύσιμες υπηρεσίες. Το ίδιο ισχύει και για τις μισθώσεις. Παρά την σχετική συγκράτηση στις τιμές ακινήτων, οι μισθώσεις συνεχίζουν να αυξάνονται με ρυθμούς υψηλότερους του Γενικού Δείκτη. Ταυτόχρονα, όσον αφορά στα τρόφιμα -και δη τα φρέσκα και εποχιακά- οι ρυθμοί παραμένουν επίσης υψηλοί.

Φυσιολογική εκτίμηση βάσει των πιο πάνω, (πέρα από την σημαντική κοινωνική τους επίπτωση, η οποία θα αυξήσει την ανάγκη για κοινωνικές δαπάνες) είναι η διάβρωση της ανταγωνιστικότητας της κυπριακής οικονομίας, κάτι που θα πρέπει να προβληματίσει πριν το φαινόμενο εκδηλώσει «συμπτώματα». Η εν λόγω διάβρωση, πέρα από την πιο πάνω ποιοτική προσέγγιση, δικαιολογείται και από δείκτες όπως είναι οι Εμπορικοί Όροι της οικονομίας και ο Πραγματικός Σταθμισμένος Συναλλαγματικός Δείκτης (REER), όπως παρατηρήσαμε και σημειώσαμε στην Ενδιάμεση Έκθεση 2024. Επιπλέον, ο αποπληθωριστής του ΑΕΠ, που εκτιμάται στο 3.9, συνηγορεί υπέρ της πιο πάνω εκτίμησης.

Στα στοιχεία των εξαγωγών δεν εμφανίζεται αντίστοιχη διάβρωση, καθότι αυτές καθοδηγούνται, σε σημαντικό βαθμό, από εξαγωγές προϊόντων και υπηρεσιών Πληροφορίας και Πληροφορικής, οι οποίες δεν επηρεάζονται σημαντικά από τις πιο πάνω συνθήκες και οι οποίες τους τελευταίους μήνες οφείλονται στην εισροή ξένων επιχειρήσεων από εμπόλεμες ζώνες.

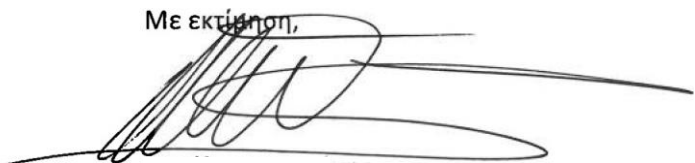
Με βάση την εικόνα του πληθωρισμού, και την εκτίμηση που απορρέει από αυτή σε συνδυασμό και τους υψηλούς ρυθμούς ανάπτυξης και την εικόνα πλήρους απασχόλησης, συνιστούμε ιδιαίτερη προσοχή στην διαχείριση των πολιτικών της Δημοκρατίας, οι οποίες σχετίζονται με τα επίπεδα τιμών. Επαναλαμβάνουμε πως η στόχευση των όποιων μέτρων θα αποτελέσει κλειδί για την αποτελεσματικότητα των κοινωνικών δαπανών.

Υφίσταται «κεκρυμμένος πληθωρισμός» σε σημαντικές νησίδες της οικονομίας, καθοδηγούμενος σε μεγάλο βαθμό από την εγχώρια ζήτηση, ο οποίος εκκολάπτει κοινωνικής φύσης ζητήματα και ο οποίος διαβρώνει την ανταγωνιστικότητα της οικονομίας. Σε σχέση με τούτο, εισηγούμαστε ιδιαίτερη προσοχή στον τρόπο διαχείρισης των όποιων αποφάσεων που σχετίζονται με την διαχείριση τιμών, την έμμεση φορολογία και τα οποιαδήποτε πιθανά οριζόντια

Καταλήγοντας, το ΔΣΚ σημειώνει πως η πλήρης υλοποίηση των νέων Κανόνων Οικονομικής Διακυβέρνησης δεν έχει στο παρόν στάδιο ολοκληρωθεί, όπως είναι φυσιολογικό. Ως πρώτη πράξη κάτω από τους νέους κανόνες, όμως, ο Προϋπολογισμός για το 2025 αποτελεί σημαντική, και σε γενικές γραμμές επιτυχή εκκίνηση στο νέο περιβάλλον. Ο Προϋπολογισμός 2025 αντικατοπτρίζει τη γενικότερη, συνετή στάση του Υπουργείου Οικονομικών, η οποία διασφαλίζει δημοσιονομική πειθαρχία και δίνει στη χώρα το περιθώριο για αντιμετώπιση των αυξημένων ρίσκων, τόσο εξωγενών όσο και εκείνων που σχετίζονται με καθυστερήσεις στην πράσινη και τη Ψηφιακή μετάβαση.

Με βάση τους νέους Κανόνες Οικονομικής Διακυβέρνησης, καλούμε το Υπουργείο να υποβάλλει στο ΔΣΚ νωρίτερα και σε πιο ολοκληρωμένη μορφή τα σχετικά στοιχεία, ούτως ώστε να καταστεί δυνατή η έγκαιρη και πλήρης ανάλυσή τους, χωρίς τους σημερινούς ετεροχρονισμούς.

Με εκτίμηση,



Μιχάλης Περισιάνης

Κοιν.: Πρόεδρο Κοινοβουλευτικής Επιτροπής Οικονομικών
Υφυπουργό παρά τω Προέδρω,
Γενικό Διευθυντή Υπουργείου Οικονομικών
Γραμματέα Υπουργικού Συμβουλίου

ANNEX 3: REFERENCE TRAJECTORY

In line with Article 5 of Regulation (EU) 2024/1263 (1), the European Commission transmitted on 20 June 2024 to Cyprus a reference trajectory as prior guidance for the preparation of its Plan for the period 2025-2028. The reference trajectory provides the European Commission's views on the appropriate growth rate of the nationally financed net primary expenditure for the four-year period.

According to the Reference Trajectory provided, Cyprus should limit its net expenditure growth to 4.9% on average over the period 2025-2028. The net expenditure growth corresponds to a decrease of the public debt from 65.8% in 2025 to 53.6% in 2028. Moreover, the public debt is expected to reach the level below the reference value of 60% of the EU Treaty by 2027, one year before the end of the Plan. Table A1 provides a summary of the reference trajectory in case of a four-year adjustment period.

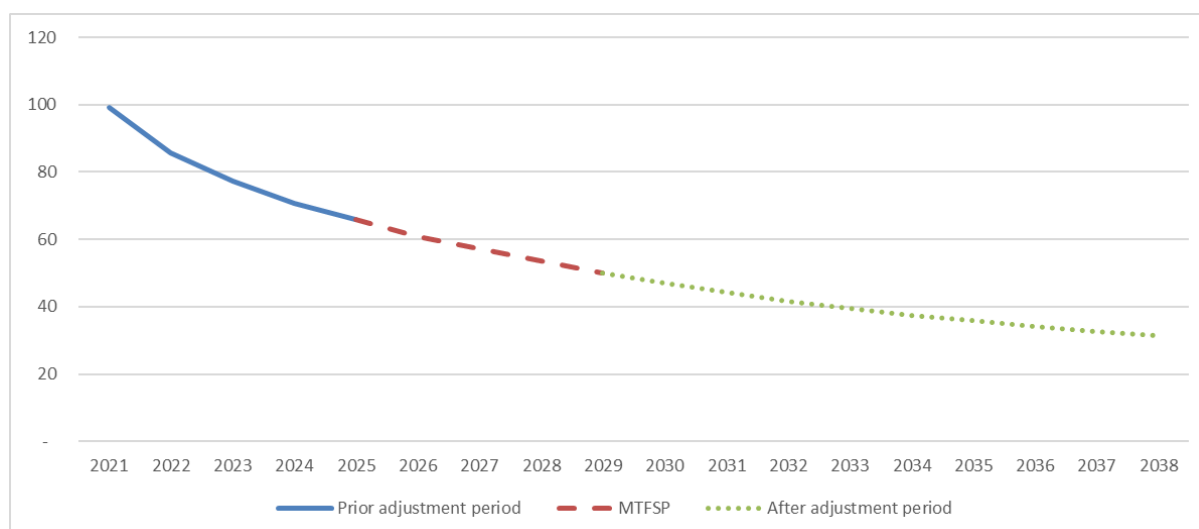
Table A1: Summary of reference trajectory

		Average	2025	2026	2027	2028
1	Net expenditure growth	4.9	5.9	5.0	4.5	4.3
2	Structural primary balance	3.5	3.5	3.5	3.5	3.5
3	Annual change in the structural primary balance of	0.00	0.00	0.00	0.00	0.00
4	DSA-based criteria	0.00	0.00	0.00	0.00	0.00
5	Impact of the benchmark and safeguards	0.00	0.00	0.00	0.00	0.00
6	Headline balance	1.8	2.4	1.9	1.5	1.2
7	Public debt	-	65.8	60.9	57.1	53.6

The net expenditure growth proposed in the reference trajectory does not require any further adjustment, indicating that the current fiscal policy of the Government is sufficient to meet the risk-based requirements. More specifically, no change in the fiscal policy is required in order to keep the public debt on a plausibly downward path by the end of 2028 and maintain budget surpluses over the medium-term. Furthermore, no adjustment is required in order to comply with the common safeguards and benchmarks. Overall, assuming that there are no further budgetary measures, the net expenditure growth is not constrained by the risk-based requirements and the safeguards and benchmarks.

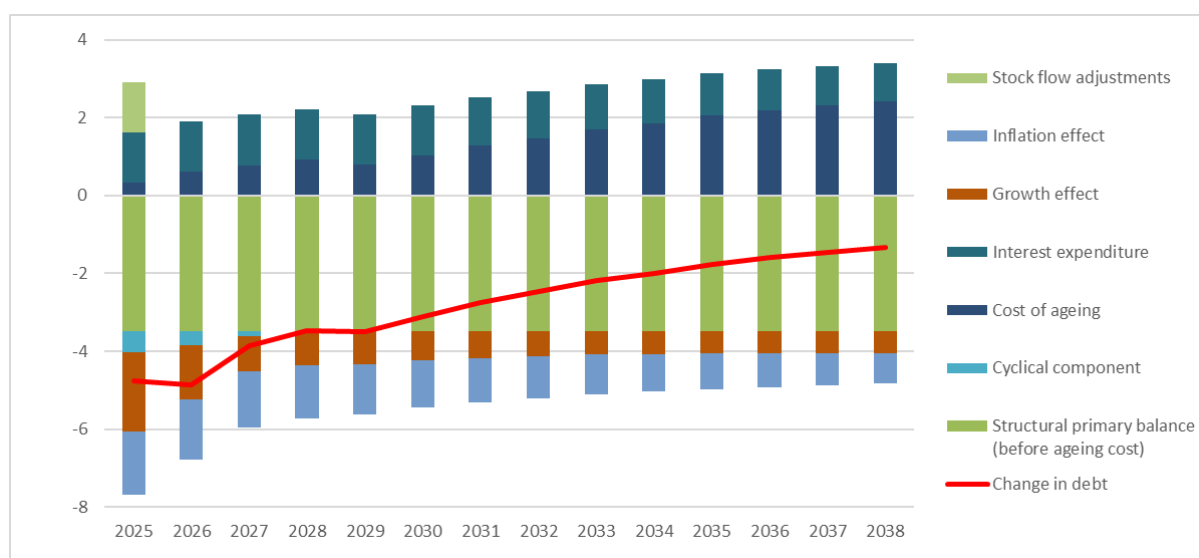
Under no policy change scenario, the debt level decreases every year in the ten-year period after the end of the adjustment period and reaches 31.4% of GDP by 2038. The evolution of public debt over the period 2029-2038 is depicted in diagram A1.

Diagram A1: Public debt evolution



The main driver of the debt decrease is the structural primary surpluses that are expected to continue throughout the Plan and in the ten-year period after the end of the Plan. However, public debt decreases at a diminishing rate, primarily as the cost of ageing on public finances are increasing over time. The snowball effect (denominator effect through developments in interest expenditure, growth and inflation) is also contributing to debt reduction during the first years of the Plan, as inflation and growth are expected to be high, however its effect fades out as these variables reach their long-term equilibrium levels. The interest-growth rate differential becomes less favourable for debt reduction over time, mainly due to rising implicit interest rates and normalization of growth. Overall, the primary structural balance and the favourable impact of the interest-growth rate differential are sufficient to mitigate the increasing pressure of ageing costs on public finances. Diagram A2 provides more insights into the drivers of the debt reduction.

Diagram A2: Change in debt levels and drivers



The macroeconomic assumptions used in the DSA model are based on the European Commission's 2024 spring forecast and its medium-term extension up to 2033, while the long-term macroeconomic assumptions (GDP growth and ageing costs) are in line with the joint European Commission-Council 2024 Ageing Report.

In addition to the baseline projections, the DSA model includes three more alternative scenarios to account for uncertainty. These are the 'financial stress', 'lower SPB' and 'adverse interest-growth rate differential (r-g)'. On top of these three scenarios, the DSA model undertakes stochastic analysis, where a very large number of shock simulations are created, based on the historical volatility and the correlation of shocks. This analysis is particularly challenging for Cyprus, given that the poor fiscal conditions of the past decades are taken into consideration when the simulations are created, however results are not indicating any severe risk. Overall, it is noted that the risk-based requirements, both under the baseline and under the alternative scenarios and stochastic analysis do not suggest that any fiscal adjustment is required.

Debt sustainability safeguard

The risk-based requirements suggest an annual average debt reduction of 4.2% of GDP, which is significantly higher than the 0.5% of GDP that is required by the debt sustainability safeguards. Therefore, the debt sustainability safeguard is satisfied without any required fiscal adjustment.

Deficit resilience safeguard

Cyprus is expected to maintain structural budget surpluses throughout the duration of the Plan, therefore the debt sustainability safeguard is satisfied without any required fiscal adjustment.

ANNEX 4: MACROECONOMIC EFFECTS OF CLIMATE CHANGE

Thematic Box: Study on the “Macroeconomic effects of climate change: the impact of energy transition on the economy of Cyprus”³

1. Background and policy context

The Economics Research Centre of the University of Cyprus conducts a model-based assessment of the macroeconomic impacts of energy transition policies aimed at reducing carbon emissions and increasing the share of renewable energy resources in the economy of Cyprus, within the framework of the revised Integrated National Energy and Climate Plan (NECP).

The consequences of the energy transition, particularly the **"net-zero transition"** outlined in the **European Green Deal** and the recently adopted **Fit-for-55 package**, may have significant implications for macroeconomic dynamics and the transmission of policy shocks, especially those of a fiscal nature. Specifically, we assess the impact of selected **"green" fiscal discretionary measures** and their contribution to achieving various NECP targets, such as a 28% reduction in greenhouse gas emissions (GHG) by 2030 (compared to 2005 levels) and an increase in the **share of renewable energy** in total energy consumption from 20% to 28%. To this end, we illustrate the short- to medium-term macroeconomic impact under different policy scenarios using model simulations.

Discretionary 'green' fiscal measures are typically implemented either on the **revenue side**, through energy taxes (primarily targeting carbon-intensive goods like fuels), or on the **expenditure side**, via green subsidies for clean energy production. These measures can be tailored to households or firms, such as specific taxes on high-emission production activities or subsidies supporting clean energy production, household income and consumption. Ultimately, these 'green' measures are expected to positively contribute to climate change adaptation by promoting energy transition and improving energy efficiency.

Given the significant role of the tradable sector (e.g. tourism and financial services) compared to the non-tradable sector in Cyprus's economic structure, our analysis evaluates the energy transition's impact at both aggregate and sectoral levels. This is crucial because, although the Cypriot economy is not heavily reliant on high-emission industries, the introduction of a carbon tax still generates widespread effects across sectors through inter-sectoral forward and backward linkages.

2. Model description

We use the in-house Small Open Economy DSGE model developed by the Economics Research Center of the University of Cyprus augmented with an energy production sector, where intermediate-goods firms in the tradable and non-tradable sectors and households demand an energy composite for production and consumption purposes.⁴ We follow closely the methodology in Coenen,LOSEJ and Priftis (2024), where the

³ The findings in this summary report are derived from a project funded by the Ministry of Finance and the Economics Research Centre on *"Climate Change and its Impacts on the Cypriot Economy,"* as well as from the research grant *"Economic Policy Modelling Hub,"* financed by the European Commission's Recovery and Resilience Plan (RRP) for Cyprus. Specifically, these results are part of the ongoing study, *"Macroeconomic Impact Assessment of the Energy Transition Using a Three-Sector DSGE Model for the Cypriot Economy"* (Mavrigiannakis K. and Sakkas S., 2024, forthcoming).

⁴ See Mavrigiannakis and Sakkas, 2024, EU Sanctions against Russia and implication for a Small Open Economy: the case of Cyprus, *Open Economies Review*, for the baseline model.

energy composite is produced using “dirty” and “clean” inputs.⁵ These inputs are in turn produced from imported **fossil resources, the use of which causes carbon emissions**, and from domestic renewable resources respectively.

3. Simulation design

We conduct a number of energy transition simulation scenarios that provide us a qualitative, and to some extent, a quantitative assessment on the impact of carbon taxes and the main channels through which they affect macroeconomic aggregates such as **output, employment and inflation**. We also examine to what extent these measures contribute to the fulfillment of the Fit-for-55 targets such as **GHG emission reduction** and the **increase in the share of renewable energy**. We also examine **policy mixes**, that is we combine fiscal policy discretionary measures along with structural policies affecting productivity in the clean energy production sector. Finally, we propose ways of **leveraging taxation policies** to strengthen price incentives and to create the context for broad-based tax reforms, shifting the tax burden from labour income to pollution or from corporate income to pollution. All of the scenarios under consideration are assumed **fiscally-neutral**. The scenarios are described below:

S1. Effective Carbon tax rate increase (benchmark): This benchmark scenario is grounded on Effective Carbon Tax Rates changes and their contribution in the total tax revenues as share of GDP.⁶ More concretely, we assume **an increase in the effective carbon tax rate of about 32.5%, linearly for 6 years (from 2025 to 2030)** so that tax revenues from energy taxes are increased by 0.8% as share of GDP (by 2030), that is from 1.8% to 2.6% as a share of GDP. Carbon taxes are imposed both on the households’ side (e.g. tax on motor fuels) and on the firms’ side (e.g. motor fuel for industries, production tax) at equal shares of the total carbon tax.⁷ Note that the final increase in the level of the effective carbon tax rate of 32.5% is substantially lower than the increase suggested by international organizations and energy authorities for achieving the net-zero target.⁸

S2. Green subsidies: In the second scenario **we assume an increase in subsidies in clean energy production**. To give a more functional role to energy taxation schemes, other than revenue generation, we assume that these subsidies are financed from the revenues generated by the increase of carbon taxes in S1.

S3. Policy mix (fiscal and structural changes): The third scenario assumes a policy mix. That is on top of the measures examined in S2 **we assume a simultaneous gradual increase of 10% in the productivity of the clean energy production sector**.⁹ This is grounded on technological and innovation improvements in the clean energy production along with possible legislative and environmentally friendly reforms that will also take place during the energy transition period.¹⁰

S4 and S5. Tax shifts: The fourth scenario considers **a tax shift from labour income taxation to energy taxation**, while the fifth scenario considers **a tax shift from capital/corporate income taxation to energy taxation**. Empirically this is grounded on empirical evidence showing that in Cyprus, in recent years, energy tax

⁵ See Coenen, Losej and Priftis, 2024. Macroeconomic Effects of Carbon Transition Policies: An assessment based on ECB’s New Area Wide Model with a disaggregated energy sector, *European Economic Review*.

⁶ European Commission, Annual Taxation Report 2023.

⁷ Based on Economic Research Center’s estimates in the context of the Cyprus Tax Reform.

⁸ See International Energy Agency, World Economic Outlook 2023.

⁹ See OECD Green Growth Papers, 2023-01, Environmentally Adjusted Multifactor Productivity: Accounting for renewable natural resources and ecosystem services.

¹⁰ The number of green reforms and initiatives is vast and diverse. A macroeconomic model cannot possibly reflect this diversity; however, we assume that all this boils down to productivity enhancement.

revenues (in particular environmental) are not increasing as much as labour tax revenues do.¹¹ On theoretical grounds it is widely accepted that environmental taxes are less distortive than other more commonly used types of taxation (e.g., labour or capital taxation) that were designed mostly for revenues raising purposes while at the same time they are supposed to correct negative externalities.

Simulation results

Figure 1 shows the evolution of the main aggregate macro variables for each scenario studied. The figure also shows the evolution of energy related measures. Overall, there is a trade-off between the macroeconomic outcomes and the EU targets.

The benchmark scenario, S1 implies that an increase in carbon taxes **lower the demand for dirty energy** and induce firms to substitute **less costly clean energy for production** of the aggregate energy good. The increase in the post-tax price of dirty energy, combined with the rise in the price of clean energy due to substitution effects, results in aggregate energy prices increases which pass through the rest of the production sectors in the economy by increasing their respective marginal costs. In turn this translates into an inflation increase in the short run. Consequently, firms' and households' real profits and real income fall, which in turn **slices investment and consumption, and hence GDP and employment**. The reduction in GDP and employment is 0.43% and 0.48% respectively, by 2030. When we disaggregate output at the sectoral level we see that the non-tradable sector is the one carrying most of the burden, since it is more energy and emissions intensive. This translates into a 0.37% drop in tradable's sector output versus a 0.61% in the non-tradable by 2030. Note also that the recovery in the tradable sector is faster while the effects in the non-tradable are persistent. The **inflationary pressures are mild**, that is 0.03 percentage points increase in the first 5 years.

On the positive side, **dirty energy production and carbon emissions decline** by 2.4% and 1.7% respectively (or about 22% relative to 2005). However, the economy cannot experience a "green transition", since the share of clean energy to total energy barely increases (from 20.0% to 20.2%). This means that, even a substantial increase of 32.5% in carbon taxes **is not enough to meet the EU targets** in terms of emissions and renewable resources share.

In the second scenario (S2), when we assume that all the revenues generated by the increase in carbon tax can be used for the financing of green subsidy model simulations show that the negative effects on aggregate and sectoral output still persists, though attenuated (0.32% compared with 0.43% in S1, that is 26% reduction). Interestingly, output in the tradable sector increases, rising by almost 0.5% in 2030, pointing to the fact that **green subsidies have productivity enhancing effects and mitigate the carbon tax distortion** for a large share of the production activity in Cyprus. Regarding the energy transition EU targets, the share of renewables increases more relative to S1, reaching a level of 22% but still is far from reaching the EU target of 28%. In a sense, there is a double dividend compared to S1 since we obtain better macroeconomic outcomes and energy transition is stronger. Inflationary pressures are stronger reaching an increase of 0.07 percentage point and appear earlier in the transition possibly due to stronger demand effects relative to the benchmark scenario.

Regarding the third scenario (S3), that is a combination of fiscal measures and productivity reforms, the plots show that negative effects on output are substantially attenuated while closing the gap with the actual Fit-for-55 targets. Aggregate output falls 0.23% by 2030 (that is 50% less than in the baseline scenario) while **output in the tradable sector increases gradually**. Instead output in the non-tradable sector falls slightly in the early years of the transition and turns positive later on. The reaction of aggregate employment follows a similar

¹¹ European Commission, Annual Taxation Report, 2023, Figure 47.

pattern but remains persistently negative. At the same time the share of clean energy production increases to 22.5%. Moreover, dirty energy production and carbon emissions decline by almost 7% and 4.5% (or about 25% relative to 2005) respectively, which are the highest values among the scenarios examined, significantly contributing to closing the gap with the Fit-for-55 targets. These results highlight the **strong and positive complementarities** stemming from the combination green subsidies and productivity reforms in terms of both aggregate efficiency and environmental outcomes.

Model simulations in S4 demonstrate that adjusting the tax mix—where an increase in carbon taxes is offset by a corresponding reduction in labor income taxes, in a debt-neutral manner—significantly mitigates the negative effects on output and employment, particularly in the short run. By 2030, aggregate output declines by around 0.3% and employment by 0.27%. In S5, reducing capital income tax proves to be the most economically beneficial, with output increasing by 0.2% by 2030. However, this also leads to stronger short-term inflationary pressures due to heightened demand.

While S4 and S5 perform better compared to other scenarios in terms of economic efficiency, their impact on EU energy tax goals is negligible in terms of emissions reduction and increasing the share of green energy. This is because lowering capital and labor income taxes significantly boosts demand for all goods (tradable, non-tradable, dirty, and green energy) and in turn sectoral outputs, effectively neutralizing any positive effects from carbon taxes.

4. Concluding remarks and caveats

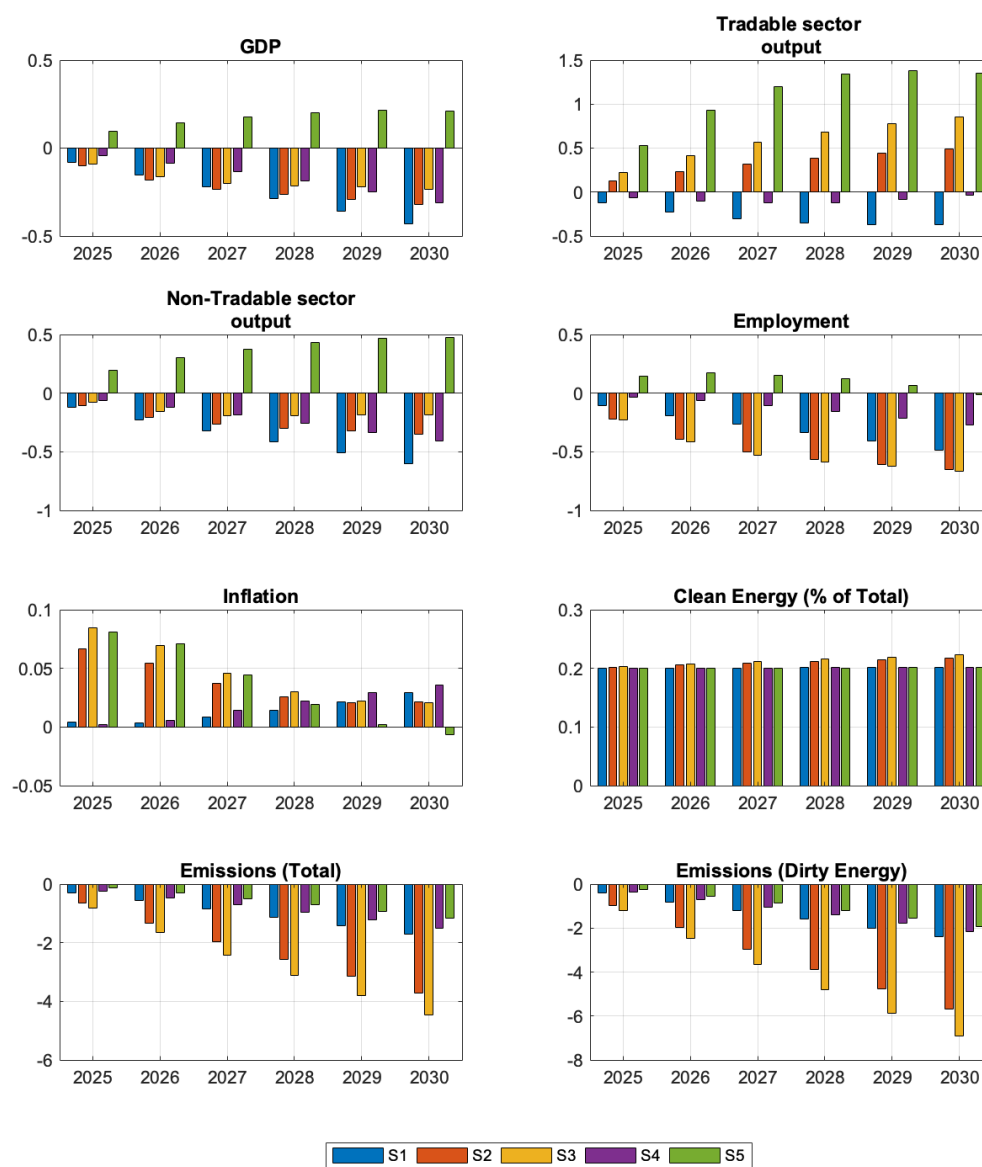
Our main finding is that **the cost of the net-zero energy transition depends heavily on the chosen policy mix**, particularly regarding the efficient use of carbon tax revenues. Allocating carbon tax revenue to reduce other distortive taxes, such as capital income or labor income taxes, can lead to more efficient economic outcomes. Conversely, **using carbon taxes to fund clean energy subsidies and productivity reforms results in output losses, but with clear environmental benefits**. Similarly **inflationary pressures are quite small**. All this is in line with findings from international organizations focusing at the EU level. For instance, European Commission (2021) reports a long run output losses at the EU level range from 1.86% to 0.61% by 2050, while carbon taxes need to increase by 94% in order to reach net zero targets by 2050. Similarly, the European Central Bank assumes that increasing effective average carbon tax rates so as to meet EU targets, **can result in higher HICP inflation in the euro area by 0.2 to 0.4 percentage points in the short run than the benchmark with no additional measures, while the level of real GDP is lower** by 2.2% in 2030. Additional compensatory measures such as clean subsidies and productivity reforms can mitigate the output losses to around 1.3%.

The following caveats should be noted. This analysis does not account for the effects of ongoing climate change on macroeconomic performance, including potential physical risks such as temperature fluctuations and natural disasters, or pollution. Additionally, we do not evaluate the effectiveness of these measures in mitigating climate change. Moreover, this analysis does not take into consideration possible socio-economic aspects of climate change, like for instance the impact of climate change on public health, demographic change and education. Regarding policy interventions, our focus remains on the impact of carbon taxes as the primary fiscal policy tool during the energy transition. However, the net-zero transition also encompasses various public and private investments under initiatives like the Recovery and Resilience Fund, the Just Transition Fund and the EU Structural Funds. These investments, along with energy saving technological progress and structural reforms, are expected to have a positive macroeconomic impact.¹² That being, the short run

¹² See Cyprus's revised NECP, Chapter 5.

estimated output losses for the Cypriot economy, ranging from 0.43% to 0.2% of GDP by 2030, **are not considered substantial** if one considers long term effects from investment on green public infrastructure and technological improvements.

Figure 1: Impact on macroeconomic and energy variables.



Note: Impacts are expressed in the vertical axis as percentage deviations from the baseline year, except for inflation and the share of clean energy production, which are expressed in percentage points changes and levels respectively.