

Extended Country Report

Financial Participation of Employees in Cyprus

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1. Background

Employee participation either in the form of financial or decision-making is not a feature observed in the corporate and industrial relations practice in Cyprus. This is observed despite the fact that, on the one hand, Cyprus has now quite developed financial institutions and practices, and a well developed co-operative sector, both involving a high share of the population, with more than 50% of the households holding shares as financial assets and, indeed, more than 50% being members in the co-operative sector. On the other hand, the industrial relations system although the social partners base it largely on voluntary regulation that allows room for joint initiatives, is at the same time characterized by relatively high union density.

From this point of view, it is important to understand and explain why financial participation has not been in the agenda of corporate governance and industrial relations and, further, to assess any incentives and disincentives concerning the adoption and development of financial participation tools in the future.

a) History

Cyprus is a small, high-income country with its per capita GDP comparable with that of the EU average, and greatly exceeding the average per capita GDP in the other 2004 accession countries. The tertiary sector (services) is considered the backbone of the island's economy, and Cyprus has been established as international businesses centre and centre for providing services. The country has a highly developed banking and insurance sector with a long tradition of tight regulation of financial markets, capital controls, and for years with limited selection of financial assets available to households. This has changed since the mid-1990s, initially through the Cyprus Stock Exchange (CSE), which launched its official operations in March 1996 in accordance with the Cyprus Stock Exchange Laws and Regulations passed by the House of Representatives in 1993 and 1995. By October 2001, the market was flirting with the 100 level, having fallen from 800 at the peak of a short-lived boom in 1999. During 2002 and 2003 the market continued a long-term decline, with brief turns to growth, reaching a level of 80 in late 2003. In 2004 and 2005 the market remained becalmed, with the index unable to break out of the range 80-90. This trajectory is important in order to have financial participation understood in context.

These new elements of the 1990s related to the Cyprus Stock Exchange boom and crisis are combined with a long tradition of developing the co-operative sector of the economy, which currently is being subject to adapting to the new EU environment. From this point of view, we may say that for decades employee participation has been mainly associated with the co-operative movement. The Co-operative Movement was introduced in Cyprus at the beginning of the 20th century. The first Co-operative Society in Cyprus was established in Lefkoniko village in 1909. In 1914 the legislative body passed Law 13 on 'Co-operative Credit Institutions'. Despite the adoption of leg-

isolation, the development of Co-operatives Societies during the following years was limited. The lack of basic funds and the absence of people with sufficient education were the main obstacles towards the establishment of such companies. In 1923, a separate law was enacted, which favoured the formation of Non-credit Co-operative Societies. In addition, during the same period, the government provided the Societies with loans up to £ 20,000 to help the development of the Co-operative Movement.

To cope with the economic problems created after the First World War, the government established, in 1925, the Agricultural Bank whose main purpose was to provide long-term credits to farmers. These loans were issued by the Co-operative Societies secured by mortgages pledged under their name. Immediately after the agreement, these mortgages were transferred to the Agricultural Bank. Despite the fact that the Agricultural Bank did not succeed in achieving the goals for which it was founded, it positively influenced the growth of the Co-operative Movement in Cyprus. The involvement of the Co-operative Societies in the lending process led people from various communities to establish such Societies with the result in 1935 the number of Societies increased to 273 compared to 24 in 1924.

Until 1936 there was no governmental department responsible for Co-operative matters. In 1935 the first Commissioner was appointed and by 1936 the Department of Co-operative Development (DCD) was founded which played a decisive role to the development of the Co-operative Principles and Movement in Cyprus. In 1937 the Co-operative Central Bank was founded, the purpose of which was the accumulation of funds and the self-financing within the Co-operative Movement. The bank accepted the surpluses of 'prosperous' Societies as deposits and granted loans under favourable terms to smaller, less well off ones. The Co-operative Societies in return, lent their members mainly in the form of short-term credits. In addition to the acceptance of deposits, the Co-operative Central Bank provided the farmers with different agricultural necessities, acted as a representative of the government for the financing of various agricultural development schemes etc., activities that still exist today.

During the period 1936-1974 the Co-operative Movement experienced a significant growth in Cyprus. However, the Turkish invasion in 1974 had devastating consequences on the Co-operative Societies and on the economy of Cyprus. The Co-operative Movement, in order to help the refugees to reactivate, established new large Co-operative Societies and/or reactivated existing ones operating in the industry sector. Unfortunately, the above action failed with a negative effect on the financial status of the Movement. The result was the dissolution of these Societies in the early 1980s.

b) Social Partners

Social Partners in Cyprus are well organised and play an active role in the development and implementation of social and economic policy. Trade Unions are mainly organised at industry level and belong to strong federations or confederations, the most important being:

- The Cyprus Workers Confederation (SEK), affiliated to ETUC;
- The Pancyprian Federation of Labour (PEO);
- The Democratic Labour Federation (DEOK).

There are also other powerful individual unions, some of which represent a specific sector of economic activity such as the Public Employees' Union (PASYDY), the Bank Employees' Union (ETYK) and the Teachers' Unions (POED and OELMEK).

The Cyprus Workers Confederation (SEK) was founded in 1943, represents and coordinates the activities of the Free Trade Unions of Cyprus. Members of SEK are seven Trade Federations. Decision- and policy-making body in SEK is the Pancyprian Congress, which elects its Secretary General. The Pan Cyprian Federation of Labour (PEO) is the Coordinating Federation of its eight affiliated Trade Unions. PEO participates in the various Tripartite Committees and bodies established by the Government. The highest decision- and policy-making body of PEO is the Pancyprian Congress. The eight Trade Unions of PEO are autonomous and elect their General Secretaries and Bodies at separate Pancyprian Conferences. The Democratic Labour Federation (DEOK) has a five member Secretariat General, which is the basic decision-making body. The Federation is composed of four Democratic Manual and White-collar Workers' Unions (DEE). The Pan Cyprian Public Employees' Trade Union (PASYDY) is the trade union of the white-collar civil servants of Cyprus. It also includes in its ranks the postal employees and health workers (medical, nursing and paramedical). Its members are organised in professional branches (76), which cover all grades in the professional hierarchy. Organised in PASYDY ranks are nearly the 98% of the white-collar civil servants. PASYDY is not affiliated to any of the Labour Federations of Cyprus but closely cooperates with them. The Bank Employees' Union (ETYK) is an independent sectoral union not associated to any of the confederations and federations.

Employers are also organised in industry or branch level associations, most of which are members of the Cyprus Employers' and Industrialists' Federation (OEBE) (which is a member of UNICE) and the Cyprus Chamber of Commerce and Industry (KEBE) (affiliated to UEAPME). The Cyprus Employers' and Industrialists' Federation (OEBE) founded in 1960, is a Pancyprian independent organization representing the business community of Cyprus. It comprises the 40 main Professional Associations and 400 individual enterprises in the Manufacturing, Services, Construction and Agricultural Sectors of the economy. The Cyprus Chamber of Commerce and Industry (CCCI/KEBE) is a private law organization, which is financially independent, thus its operation is under no influence by the state. The Chamber is funded by its members' subscription fees and through income generated from the offer of services.

The voluntarism that has been developed through the Industrial Relations Code operates also via National Tripartite Bodies. Given the tradition of social dialogue and voluntarism Cyprus not surprisingly has a set of national tripartite bodies such as the Labour Advisory Board, dealing with the main issues of industrial relations and an

equally important Economic Advisory Committee dealing with economic policy issues. The tripartite bodies work as integrated functions of the Ministries¹.

The voluntarism in industrial relations is coupled with relatively high union density estimated at 65-70%, and similar high levels of coverage by collective agreements. According to Ministry of Labour estimates 41% of employees have their pay and working conditions defined by sectoral collective agreements (covering approximately 74,000 employees), 6% of employees have their pay and working conditions defined by agreements in the semi-government sector (covering approximately 10,000 employees), 25% of employees have their pay and working conditions defined by company collective agreements (covering 45,000 employees) and 17% of employees have their pay defined by agreements in the public sector (covering approximately 33,000 employees). The government set pay (the minimum wage) and the minimum standards to cover segments of the remaining 11% of employees (approximately 20,000) that are not covered by collective agreements.

Although the social partners shape the evolution of industrial relations employee participation has not been an issue high in their agendas. Only SEK initiated during the 1990s positions in favour of employee representatives' participation in decision-making through participation of labour representatives at the Board level of public sector and semi-public sector institutions and organizations, without success.

Although recent developments associated with the transposition of EU directives accelerated the broadening of their policy agendas towards the implementation of the *acquis communautaire*, without, until now, bringing financial participation of employees in the main issues of interest.

c) Policy-Makers

Cyprus gained its independence in 1960. The yearly rate of growth during the first years of independence had reached 7%. The favourable results of 13 years of development were led to a temporary halt as a result of the Turkish invasion and occupation of the northern part of Cyprus in 1974. For a while, the economy faced many difficulties and was brought to the brink of total collapse. It managed, however, to recover and to develop. Over the last two decades economic performance has been impressive, with GDP per capita rapidly approaching the average level in EU countries.

Strong growth has kept the unemployment rate below 4% for the past two decades, inflation has remained under control, and the fiscal deficit has averaged below 3.5% of GDP during the past decade. The progress achieved on the reform agenda (including with respect to the financial sector and the operation of modern financial policy tools, the abolition of the interest rate ceiling; the granting of legal independence to the

¹ A Redundancy Board and a Central Board for Annual Holidays with Pay complete the set of national tripartite bodies.

Central Bank; continuing capital account liberalization; and the reform of the tax system) has helped pave the way for European Union membership in 2004.

In this context national policy makers have focused in the pre-accession period on priorities related to the *acquis*, i.e. reforms concerning the binding provisions of the EU and for the moment leaving aside normative proposals such as that concerning the development of employee financial participation schemes in the economy.

In the labour market, the number of registered unemployed as a proportion of the economically active population reached 3.6% in 2004 compared with 3.5% in 2003. The number of registered unemployed increased by 5.8% in 2004, compared with 13.3% in 2003. It is also worth mentioning that, according to the labour force survey, the unemployment rate reached 4.3% in 2004, compared with 4.1% in 2003. Inflation at 2.4% in 2004 has been also under control and the main concern of the policymakers has been the government's budget aiming to have public sector deficit within the 3% Maastricht criterion, with the government implementing a fiscal plan aimed at entry into the Euro zone by 2008.

2. Types of Schemes and their Legal Foundations

The Cyprus legal system is based on the same principles as those applicable in the United Kingdom and all laws regulating business matters and procedures are based essentially on English law. English case law is cited in the Cyprus Courts and is of persuasive authority. A new and emerging influence now comes from the *acquis communautaire* in the context of harmonization. It is in this context that the legal, institutional and fiscal environment concerning employees' financial participation is set.

As in other country-cases the institutional and the legal framework generally do not - at least intentionally - create incentives for, but neither do prevent, the development of PEPPER schemes. However, new forms of employee participation such as ESOPs would require at least new bipartite agreements and the relevant regulatory framework.

a) Corporations

Registered companies in Cyprus are governed in the main by the Cyprus Company's Law, Chapter 113 of the Laws of Cyprus, as amended, which is identical to the UK's former Companies Act 1948. Companies under the Company's Law can be divided into Companies limited by shares², Companies limited by guarantee³, Companies

² It is the most common form of limited company. The liability of each member is limited to the nominal value of the shares that he has agreed to take up for or if he has agreed to take up such shares at a premium, for example, at more than their nominal value, to the total amount agreed to

2. Types of Schemes and their Legal Foundations

which are limited by shares can be subdivided into Private companies⁴, and Public companies⁵. Other types of businesses include Branches (foreign/overseas company), and Trusts.⁶

Cyprus Company's Law does not contain special rules on employee profit-sharing and only a mere notion of employee share ownership.⁷ The provisions of the Second Council Directive 77/91/EEC of 13 December 1976 were implemented into the national legislation and specifically in the Company's Law. Therefore, in deviation from the general prohibition to acquire own stock, Article 57A of the Cyprus Company's Law permits a company to acquire its own shares not requiring a special resolution of the general shareholders assembly⁸, if the shares are acquired for the purpose of being transferred to the company's employees or to the employees of an associate company. In order to facilitate the acquisition of shares by employees Article 53 of the Companies Law permits that the company may advance funds, make loans, provide security, with a view to acquisition by employees of the company or employees of an associate company.⁹ The term 'employee' includes also directors holding a salaried employment or office in the company.

be paid for such shares. Subsequently, once the member has paid for his shares, his liability towards the debts of the company is fully discharged.

- ³ In the majority of cases, companies of this nature are incorporated as non-profit-making organizations. Companies limited by guarantee can be registered with or without a share capital and the liability of each member is limited to the amount agreed on in the memorandum of association to be contributed in the event of the company going into liquidation.
- ⁴ In order for a company to be registered as a private company its article of association, restricts the transfer of its shares, limits the number of its members to 50 (The Companies Amendment Law of 2000, Law 2(I)/2000, introduced single-member companies), prohibits any invitation to the public to subscribe for its shares or debentures and prohibits the issue of bearer shares.
- ⁵ The Companies Law does not give a specific definition of what is a public company. However, it can be concluded that a public company is a corporation which does not constitute a private company. The main characteristics of a public company are a minimum number of seven members, at least two directors, If directors are appointed by the company's articles, the consent of these directors filed on incorporation, a trading certificate from the Registrar of Companies, a statutory meeting reported by the directors to its members and a prospectus or a statement in lieu of prospectus issued before issuing any of its shares or debentures to the public.
- ⁶ Local Trusts are governed by the Cyprus Trustees Law Cap 193, which closely follows the English Trustee Act 1925. Offshore Trusts are the same as local trusts, but their beneficiaries must be non-resident, and all the trust's activities must be outside Cyprus. As with 'offshore' companies, the special tax status of offshore companies has ceased with Cyprus's accession to the EU. International Trusts subject to the International Trusts Law of 1992 brought Cyprus trust law into line with that of other major international trust jurisdictions.
- ⁷ Neither does it contain any special provisions concerning the employees' participation in control and decision-making in corporations.
- ⁸ As the general provision for a company acquiring its own shares stipulate.
- ⁹ Regulation about employee shares in the context of capital does not exist; although Art. 60 of the Cyprus Company's Law provides that a company may increase its share capital by approval in general meeting, if the company's memorandum authorizes such an increase, newly issued shares

Employees are not restricted to acquire shares; in fact it is a common phenomenon especially in public companies listed in the Stock Exchange for employees to buy shares of the company which employs them. By doing so, employees do actually participate in some degree in the decision-making process of the company and in the profit-sharing system. Of course as it was previously stated in the introduction above a new and emerging influence comes from the European Union and a much more intensive effort is observed by the authorities concerning the implementation of the EU Directives. Therefore, employee participation at a Community level has to some extent been safeguarded by the implementation into Cyprus national law¹⁰ of Council Directive 2001/86/EC on supplementing the Statute for a European company with regard to the involvement of employees. The aforementioned Directive complements Council Regulation 2157/2001 on the Statute for a European company (SE) and both must be applied concomitantly.¹¹

The provisions of the Cyprus Law regarding employee participation in the European Company, which implements the Council Directive, govern employee involvement in an SE, ensuring that employees have a right of involvement in issues and decisions affecting the operation of their SE. The Law secures employees' acquired rights relating to their involvement in company decisions and ensures that the establishment of an SE does not bring about the disappearance or reduction of practices of employee participation. Other social and labour legislation issues, such as employee rights concerning information and consultation as regulated in the Member States, are within the scope of existing national provisions, as these apply to public limited-liability companies.

One can suggest that the rights to participate in decision-making provided by EU legislation typically apply after the harmonization with the EU *acquis* although these remain more a right to be exercised and less a practiced reality because of the absence of cases up to the present.

must primarily be offered to existing shareholders in proportion to their existing shareholding (pre-emption rights).

¹⁰ By virtue of Law No. 277(I)/2004.

¹¹ The underlying purpose of the Regulation is to ensure the concision of economic and legal units of business within the Community, by creating a uniform legal framework for the reorganization of companies from different Member States. The restructuring and cooperation operations involving companies from different Member States gave rise to various legal and technical obstacles as well as tax problems. And despite the approximation of Member States' company law by means of Directives, the problems were not eradicated completely given that companies governed by diverse legal systems were obliged to opt for a form of company governed by a specific national law. Therefore, with the passing of the Regulation the reorganization of company businesses can be carried out on a Community scale. The Regulation permits the creation of companies with a European dimension, eliminating any disparities and inconsistencies caused by the limited territorial application of national company law.

b) Partnerships

Partnerships are a traditional business form utilized mainly by the liberal professions such as lawyers and until recently auditors.

Partnerships are registered in Cyprus under the Partnerships and Business Names Law, Chapter 116 of the Laws of Cyprus which is based on English legislation. According to the law there are two forms of partnership, namely general¹² and limited¹³ partnerships. In both cases a partnership may consist of between two and twenty natural or legal persons.

The most important disadvantage of partnerships is personal liability of partners, which continues to exist even after a partner's death and passes onto the deceased partner's estate which is severally liable for all the debts and obligations of the partnership. The aforementioned feature of the partnerships has made limited liability companies a more attractive alternative with the result that partnerships are created and used only in the cases where legislation does not permit the use of limited companies (for example in the cases of law firms).

There is no specific legal regulation as concerns the financial participation of employees and the participation of employees in the decision-making process in partnerships. Usually employees, apart from the salary are paid, are awarded with bonuses according to their performance and the tasks they complete. Of course it is always open to an employee to join the partnership (provided that the existing partners agree) by contributing an amount to the partnership's capital.

c) Privatization

There is no specific legislation on privatization in Cyprus. If any semi-governmental institution ever proceeds with privatization a private limited company need to be formed first so as the business is transferred after the special law has passed. As to the employees rights these will be agreed with the employees' unions and their employers.

¹² In a general partnership, which is the most commonly used form of partnership in Cyprus, each partner has unlimited liability severally and jointly with the other partners for all the debts incurred by the partnership while he is a partner.

¹³ Limited Partnerships are similar to general partnerships except that they have one or more partners with unlimited liability and one or more limited partners, whose liability is limited to the amount declared in the partnership return filed with the Registrar. Limited partners must contribute a stated amount to partnership's capital at the time of joining it.

d) Co-operatives

The Law on Co-operatives (hereinafter Coop Law) that defines the types of Co-operatives and their hierarchy originates since 1914 but it has been updated since 2000 to conform to EU provisions¹⁴. The law provides that a Co-operative can be registered either as a limited liability company or as an unlimited liability company (Art. 6 Coop Law). However, in both cases the law states clearly that the members' liability is limited and cannot be sued personally for any liabilities, debts and or obligations of the Co-operative. In the case where a Co-operative is registered as an unlimited liability company its members liability is unlimited only if the Co-operative goes into liquidation which is highly unlikely. Employees of the Co-operatives can also be members however there are no specific provisions in the law, which give incentives to the employees to become members. Nearly all the employees are members of the co-operatives though because they can have loan facilities as the rest of the members (Art. 14 Coop Law). The Profits of Co-operative Credit Institutions from operation with members in term are tax exempt.

In 2001 the Co-operative Movement reached a settlement concerning the harmonization of the Co-operative Credit Sector with the *acquis communautaire*. The beginning of necessary reforms was set so that the Co-operative Credit Sector will be fully harmonized with the *acquis communautaire* and at the same time enhances its status. The European Union has granted a transitional period for the full harmonization of the Co-operative Credit Institutions with the *acquis communautaire* until the end of 2007¹⁵.

¹⁴ The current law is based on No 22 of 1985 and 68 of 1987 which were amended by 190/89, 8/92, 22(I)/92, 140(I)/99, 140(I)/2000, 171(I)/2000, 8(I)/2001, 123(I)/2003, 124(I)/2003, 144(I)/2003, 5(I)/2004 and 170(I)/2004).

¹⁵ Based on the agreement between Cyprus and the European Union, the harmonization of the Co-operative Credit Sector with the *acquis communautaire* is followed through based on a detailed action plan, which involves the following:

- Harmonization of the legislation of the Co-operative Societies with the related European Directives.
- Adoption of implementation measures for the establishment and operation of the necessary supervisory and monitoring systems of the Co-operative Credit Sector that are required by the related European Directives.
- Computerization of the operations of the DCD for a more effective and efficient supervision.
- Promotion of further personnel training of the DCD and the CCSSs in order to respond to the new needs and requirements.
- Establishment of arrangements for permanent affiliation of a number of CCSSs with the Co-operative Central Bank Ltd, which will serve as the 'Central Body'. (Participation to the permanent affiliation arrangements can be either by CCSSs that will or will not fulfil the requirements of the European Directive 2000/12/EC as 'stand alone')
- Adoption of the *acquis communautaire* by the CCSSs through reorganization and restructuring, including merging based on their operational activities or geographical area of operations.
- Upgrading of the CCSSs activities and operations, especially for the small sized ones, to improve their profitability and to obtain the necessary 'critical mass'.

It is noteworthy that the harmonization with the European Directive 94/19/EC on deposit guarantee schemes has already been adopted. Also, Cyprus including the Co-operative Credit Sector is fully harmonized with the European Directive 91/308/EC on prevention of the use of the financial system for purpose of Money Laundering. Apart from harmonization with the *acquis communautaire* on Chapter 3 (Freedom to Provide Services) and Chapter 4 (Free Movement of Capital), which was mentioned above, the way of harmonization of the Co-operative Movement with Chapter 6 (Competition Policy) and specifically on state aid would proceed as follows:

- Profits of the Co-operative Credit Institutions that result from operations with members will continue to be exempted from corporate income tax but profits resulting from operations with non-members will be subjected to corporate income tax and
- The replacement of the current scheme regarding mortgage fees with a new one that will exempt all clients of credit institutions including commercial banks for housing loans up to £ 60,000

e) Profit-Sharing

There is no prohibition in the Cyprus legal system with regard to profit-sharing of companies with their employees. However, there is no explicit regulation linked to that. There is always of course the possibility that a company may agree with its employees for bonuses schemes according with their performance or for percentages (commissions) according with the sales that their department has made.

f) Employee Share Option Schemes

There is no law in Cyprus on share options schemes for employees but these may be included in the private employment contracts or may be decided upon by the company so as to give these options to employees as part of an incentives scheme.

g) Taxation Issues

In the summer of 2002, the House of Representatives of Cyprus enacted a series of new laws amending the existing legislation. The objective of these amendments was clearly the streamlining of the taxation system in order to comply with the *acquis communautaire*.

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- Reorganization and upgrading of the Department of Co-operative Development in order to enhance its administrative capacity and supervisory role as the Competent Supervisory Authority.

Personal Income Tax

An individual is considered a resident of Cyprus, if he/she lives in Cyprus for one or more periods, which exceed the total of 183 days per fiscal year. All individuals that are resident in Cyprus are taxed at the following rates:

Chargeable Income (CY£)	Tax rate (%)
Up to 10,000	Nil
10,001- 15,000	20
15,001- 20,000	25
20,001- and above	30

Cyprus tax residents are subject to tax in Cyprus on their worldwide income, whilst non-residents are subject to tax only on their income derived from within Cyprus. There are certain exceptions from income tax depending on the type of income. Therefore, interest, dividends, profits from a permanent establishment abroad (under certain conditions), lump sums received by way of retiring gratuity and computation of pension, capital sums accruing to individuals from any payments to approved funds (e.g. provident funds) and profits from the sale of securities¹⁶ are completely exempt.¹⁷ Bonuses paid to employees for their performance are not exempt from income tax. Moreover, under the Capital Gains Tax (Amendment) Law, No. 119 (I) of 2002, effective from 1 January 2003, gains accruing from disposal of shares listed on any recognised Stock Exchange will be exempted from tax. Gains from the sale of shares listed on the stock exchange are excluded from capital gains tax.

Corporation Tax

There is no longer a distinction between local companies and IBCs (International Business Companies) if management and control of the latter is exercised from Cyprus. Therefore all provisions mentioned below equally apply for IBCs. The taxable profits of all Cypriot companies will be taxed at the rate of 10%. The taxable rate for semi-government organizations (such as Cyprus Telecommunications Authority) is 25%. The following types of income are not subject to taxation:

1. Profits from the disposal of shares, debentures, bonds and other securities of companies or other legal entities, incorporated in Cyprus and abroad.
2. Dividends in Cyprus and abroad.

¹⁶ Securities is defined as shares, bonds, debentures, founders' shares and other securities of companies or other legal persons, incorporated in Cyprus or abroad and options thereon.

¹⁷ Apart from the above mentioned exceptions there are certain tax deductions. Therefore, the whole amount for contributions to trade unions or professional bodies and donations to approved charities (with receipts) is deducted and so is 20% of rental income.

3. 50% of the interest income is exempt. However, this exemption does not apply if the interest income was derived from the ordinary trading activities of the company.
4. Profits received in Cyprus from permanent establishment abroad under certain conditions.

h) Link to Participation in Decision-Making and Industrial Relations

Industrial relations in Cyprus are based on the Industrial Relations Code¹⁸, which has been a joint agreement between the two major labour confederations Pan Cyprian Federation of Labour (PEO), and the Cyprus Workers Federation (SEK) and the Cyprus Employers Federation, signed in April 1977. The 1977 Agreement replaced the 1962 agreement for the Industrial Relations Code.

The national corporate governance system in Cyprus assigns companies operating on the basis of the one-tier system an administrative organ (Board) in which management and supervisory functions converge. With regard to board-level representation the practice in state and semi-state companies has been for the government to appoint from time to time high-level trade union officials, mainly from the confederations, to the administrative boards of state-controlled organisations, although this is not strictly in accordance with the law, rather a legacy of state management. Indeed, after having been appointed frequently they do not mainly represent their confederation but act as independent personalities.

In Cyprus there are no legal rules concerning worker board-level representation. Neither in corporate governance legislation nor in industrial relations legislation has there been any formal right of workers' participation at board level, and therefore workers' participation at board level has not been compulsory, even as an institutionalised option.

An indicative case of workers or their representatives being able to nominate a member to a company board is in the semi-government sector, namely the Human Resources Development Authority (Arxi Anaptyxis Anthropinou Dynamikou), which deals with the funding of training and human resource activities. The workers' representative here does not represent the workers employed by the Authority, but participates in tripartite consultation with regard to human resource policy. Representatives

¹⁸ The code has 4 parts. Part one regulates Substantive provisions such as the right to organise, collective bargaining collective agreements and Joint Consultation, Issues Proper for Collective Bargaining and Joint Consultation and Management Prerogatives. It also regulates announcements procedures and provides for the implementation of conventions and Recommendations of the ILO. Part 2 refers to Procedural provisions such as the procedure for the settlement of disputes about interests through direct negotiations, Mediation, Arbitration and Public Inquiry, the procedure for the settlement of Grievances through direct negotiations, mediation and arbitration and the regulation of dismissals. Part 3 concerns with the registration of copies of claims and collective agreements with the Ministry of Labour and Social Insurance, and Part 4 clarifies the indefinite duration of the Industrial Relation Codes and sets the principle for its modification.

are drawn from the main trade union confederations. Apart from this, no other companies have worker board-level representation and this explains the difficulties in tracing worker board members in Cyprus.

3. Incidence Now and Over Time

No comprehensive information is available on the overall incidence of PEPPER schemes in Cyprus. Interviewing of social partners representatives failed (until now) to locate a single case, except the stock options schemes that were only available to top managers, i.e. not broad based stock options.

a) Economic Structure - Enterprises

The Cypriot economy is dominated by services, with tourism particularly important as a high proportion of GNP (around 40%) is based on tourism. According to the Census of Entrepreneurship of 2000 there were 69,369 enterprises employing 268,064 persons. At the same year the labour force survey estimated a labour force of 309,093 of which 293,739 employed and 15,354 unemployed. From those employed 222,529 were employees in dependent employment. The Census 2005 data are not available yet but there are estimates that these have increased by 10,000 and total 80,000 enterprises. The sectoral distribution of enterprises is as in the following table:

Sector	Units	Employees
Manufacturing	6,679	37,393
Construction	6,325	24,528
Commerce	20,292	53,934
Hotels and restaurants	7,314	33,604
Transport and communications	4,835	21,897
Banking and insurance	1,792	15,599
Business services	3,751	14,464
Public administration	977	17,866
Education	2,233	15,244
Health and welfare	2,428	11,866
Personal and social services	5,432	14,135
Households employing personnel	7,311	7,534

Source: Statistical Service of the Republic of Cyprus (Cystat), Census of Enterprises (2000).

With regard to the average size of enterprises and units in 2000 the 58% of the enterprises employed one person, the 37% employed 2-9 persons, 4% employed 10-49 persons and only the 1% exceeded the limit of 50 employees. This amounts to 99.9%, which means that only 70 companies in Cyprus employed more than 250 employees.

b) Employee Shares

There are no cases of securities issued by a company and offered solely to employees or managers of that company, and this is mainly due to the absence of employee financial participation tradition in Cyprus, and to the relatively new, recent emergence of the stock market in a relatively small economy dominated by small size of businesses. Since employees as citizens and not as employees per se of the companies listed in the Cyprus Stock Exchange, or in the Public Limited companies who became shareholders in the context of the booming Cyprus Stock Exchange, since 1999 acquired shares in listed companies and their rights are not diversified to other typical shareholders.

Even in the developed financial sector and in banking¹⁹ the only means of financial participation traced refer to loans to employees to buy shares during the stock exchange boom period in 1999, which after the crash of 2001 caused an issue in collective bargaining on settling the loans through low interest rates. The dominant pattern in that period referred first to the banks informally or unilaterally supporting loan taking by their employees to invest in the Cyprus Stock Exchange in general not only their own stocks – although a priority was given to the latter.

At the latest stage after the stock market crash of 2001 the issue became one of deleting bad debts and curtailing high loan rates to help employees to minimize losses and maintain their shares presence in the Stock exchange. This has been a recurring issue in the bargaining procedures of the banking sector for instance.

Further research is to clarify the existence of any PEPPER schemes, or the reasons why employee financial participation is not yet developed despite a legal, institutional and taxation environment that is not against (i.e. provides no disincentives to) the development of financial participation schemes and in the context of high participation rates in various financial schemes.

¹⁹ There are currently 14 domestic banks operating in Cyprus, 11 commercial banks and 3 specialised financial institutions. All banks are incorporated in Cyprus with the exception of Arab Bank plc and National Bank of Greece S.A., which operate as branches of foreign banks. The commercial banks incorporated in Cyprus are: Bank of Cyprus Ltd, the Cyprus Popular Bank Ltd, Hellenic Bank Ltd, Co-operative Central Bank Ltd, Universal Bank Ltd, Alpha Bank Ltd, National Bank of Greece (Cyprus) Ltd, Emporiki Bank - Cyprus Ltd, Société Générale Cyprus Ltd. The latter four are subsidiaries of foreign banks. The specialised financial institutions are the Cyprus Development Bank Ltd, the Housing Finance Corporation and Mortgage Bank of Cyprus Ltd. In addition to the domestic banks, there are currently 29 international banking units, which have been authorised by the Central Bank of Cyprus to operate from within Cyprus.

c) Employee Privatization on Preferential Terms

The transformation of public sector and of public utilities through privatizations, which dominates most of the enlargement countries, is not observed in Cyprus. On the one hand the market economy has been dominant, and on the other hand the role of the state remained important and the impact of privatization has been marginal, partly because to limitations on the potential for competition²⁰, limitations that are related to the size of the local markets and to the necessary investment and economies of scale that are a precondition for new entrants to compete in existing markets. Two factors may account for the lack of employee privatization on preferential terms. First the lack of mass privatizations as observed in the state-controlled economies of the east European countries in transition since the early 1990s. Second, the size of the economy and of the business sector structure that does not seem to favour employee privatization on preferential terms.

Privatization has raised numerous political discussions and the process of transforming governmental corporations to private ones is moving considerably slowly. This is probably due to the political scene that emerged in Cyprus after the last elections in 2003 where the left-wing party's candidate took office. Despite the reluctance of the new government to proceed with privatization Cyprus has complied with its EU obligations as far as the area of telecommunications and aviation is concerned by permitting also private corporations to provide the two aforementioned services.

d) Employee Stock Ownership Program (ESOP)

There is no available evidence of similar practice in Cyprus. An overview of possible sectors and companies that may adopt such schemes (e.g. the bank assurance sector) suggests the lack of relevant practices and programs.

e) Self-Entrepreneurs

In the Cypriot economy self-employment has been a permanent feature with self-employed persons accounting for 20% of the active labour force. It is also observed that salary and wage earners undertake also small-scale entrepreneurial activity, thus being 'multiple-jobholders' - especially with regard to the development of the services sector. Indeed self-employed can easily evolve as small (in fact micro- entrepreneurs).

²⁰ See also EIRO, Industrial relations in the public utilities.

f) Co-operatives

The co-operative sector in Cyprus incorporates²¹ 673 entities of which 652 at the primary level (with physical persons as members, with a minimum of 12 persons), 11 at the secondary level (with members both individuals –at least 12- and primary level co-operatives, one next to the individual members, or five primary level co-operatives) and 1 at the tertiary level (with only secondary level co-operatives as members), overall involving 387,960 persons. Despite the negative economic consequences of the Turkish invasion in 1974, the Cyprus Co-operative Movement survived and today it is considered as one of the strongest and well-organized Co-operative movements worldwide. This strength is expected to continue in the context of Cyprus' accession to the European Union. Concerning the agricultural sector of the Co-operative Movement and its harmonization with the European *acquis*, the DCD is encouraging and contributing to the transformation of Co-operative Societies into Producers' Organizations based on the related *acquis* (fresh fruit, vegetables, citrus, carobs etc.), in order to ensure their long-term sustainability and development.

Up until today, the existence of monopolies in the agricultural markets was evident. Through the harmonization, the DCD is promoting the participation of the Co-operative Movement through Producers Organizations to the liberalization of the agricultural markets. The elimination of the current monopolies offers the Co-operative Movement important opportunities for further development. The Ministry of Commerce, Industry and Tourism in cooperation with the DCD and the Co-operative Movement are making a lot of effort for a successful harmonization with the *acquis communautaire* and further development of the Co-operatives in Cyprus.

Although the traditional co-operatives sector still has a dominant role and is in transition, only after the transformation of its traditional character. Only after its transformation to comply with the EU *acquis* as analysed earlier in this report we may refer to the existence of co-operatives in the sense of a PEPPER schemes.

g) Profit-Sharing

Profit-sharing is not practiced in Cyprus while other forms of monetary incentive schemes are occasionally used in companies practicing modern HRM. Neither the literature review nor the interviews with social partners representatives enabled us to trace any practices of profit-sharing.

²¹ According to 2002 data.

4. Empirical Evidence of Economic and Social Effects

The lack of PEPPER schemes in practice implies no evidence with regard to its impact in Cyprus business and industrial relations practices.

Cyprus households' attitude towards investment and risk are characterized by high participation rates in various financial and non-financial assets. While investment companies have been a major factor in the expansion of the stockholder base, since the operation of the Cyprus Stock Exchange in 1996, and on the way to the 1999 'boom', it is noteworthy that, even after the tremendous stock market crash in 2001, half of the Cyprus population still held stocks in 2002. It is likely that some of these investors were 'trapped' in the stock market following the crash, by their desire to avoid realisation of huge losses²².

The existing evidence for the years 1999 and 2002, based on the results from the Cyprus Surveys of Consumer Finances (CySCF), suggests²³ that as far as financial assets are concerned, stocks are the most important and reported the most important increases in households' participation rates. While government bonds reported the most important decreases as shown in the comparison of the 1999 and 2002 CySCF Participation rates in stocks more than doubled, practically across all age groups in 2002 (see Table 1 in Appendix). It is noteworthy however that more substantial is the increase reported in the rather economically inactive age groups, i.e. the age groups 60-69 and above 70 which, however, can be explained by the massive purchases by elderly people of the stock 'Demetra' issued by the co-operative sector.

In 2002 there was an increase in portfolio breadth across assets and across risk categories, suggesting an increase in portfolio diversification of Cyprus households. About a fifth of households were reported to hold four assets and over 60 percent of households invested in 'safe and fairly risky assets only' compared with 41 percent in 1999. Participation in non-financial assets such as investment in real estate, primary residence, cars and business equity, did not register significant changes between the two Surveys.

²² This is sometimes called 'disposition effect'. The very limited trading volume in 2002 compared to 1999 is consistent with this view (see Antoniou et al., 2004).

²³ Antoniou et al., 2004.

5. Conclusions

The current level of development of employee financial participation in Cyprus is not observed. Indeed no comprehensive information is available on the overall incidence of PEPPER schemes in Cyprus. The rather minimal development of PEPPER schemes in Cyprus is due to the fact that the issue - for many years - is not part of the policy agenda. The current level of development of financial participation of employees appears to be rather low. It is due to the fact that the aims of economic policy of the government in the last decade have not been familiar with the idea of participation of employees, i.e. of financial participation, favouring the voluntary arrangements in industrial relations.

Indeed no major policy for privatizations has been operating - as in the Central Eastern European accession member states- and there was no such a need to the extent that Cyprus has been a competitive market economy with a developed co-operative sector. However, there is a program for opening up public sector utilities to the EU competition and this may facilitate the employee ownership schemes. Another source of further development towards employee financial participation may be the number of co-operatives and the extensive number of self-employed which is large.

There is no special legal regulation of any PEPPER scheme and in this context the legal framework provides neither incentives nor restrictions concerning the financial participation of employees. Employees who are largely shareholders, but not mainly in the companies they are employed by, when they are minority shareholders have only a limited possibility to influence the management of the company under the national company law. According to tax law, it is more profitable for employees to receive dividends than wages because employees pay no taxes on dividends, but the opposite is advantageous for the company because the company is obliged to pay taxes on dividends whereas it has to pay no taxes on employees' wages and no corporate income tax.

The necessity of transforming *acquis communautaire* into national law, a prerequisite to EU accession, has not yet enriched the debate on employee participation in decision-making and neither the government nor the social partners at present promote or plan to promote financial participation in any form. The necessity of transformation of *acquis communautaire* into national law in connection with the EU accession has recently led to debates concerning the evolution of the voluntary based system of industrial relations, but has not touched yet on issues of employee participation in decision-making, with the minor exceptions of the Laws transposing the directives on Involvement of Employees in the Activities of EC-scale Undertakings, EC-scale Groups of Undertakings and European Companies transforming EC directives 94/45/EC and 2001/86/EC. But at the moment there is no registered European Company in Cyprus.

Neither the government nor the social partners have the issue of promoting or of planning to promote financial participation schemes in their agenda. Political forces and the trade unions, which could have promoted the idea of employees' participation,

may have first to implement the idea of employees' participation in decision-making and then consider - or in parallel - the issue of financial participation. However, the process of transposition of EU directives suggests, the issue may gain further momentum.

No comprehensive information is available on the overall incidence of PEPPER schemes in Cyprus. There is no empirical research on the existence and the effects of such schemes. However, we may forecast that PEPPER schemes may become an emerging issue in Cyprus after the accession of the country to the Euro zone and to the monetary union, as the issue is the current top priority in policy-making, after completing the transposition of the *acquis communautaire*. These both can rapidly enhance the transformation of the voluntarism- based industrial relations system and its enrichment with PEPPER practices.

Annex

Table: Household participation in various assets

	1999	2002
	%	%
Assets		
<i>Financial</i>	89.8	92.9
Liquid accounts	82.2	85.2
Government bonds	50.7	43.6
<i>of which:</i> Development stock	1.6	0.8
Saving certificates	0.4	1.4
Savings bonds	48.1	41.1
Other bonds	5.1	10.6
Stocks	25.3	51.4
Mutual funds	0.4	1.0
Retirement accounts¶	12.5	51.3
Life insurance investment policies	31.1	32.8
Term insurance	18.0	13.5
Whole life insurance	8.5	10.5
Endowment insurance	9.5	12.5

<i>Non-financial</i>	98.2	100.0
Primary residence	86.0	83.1
Investment real estate	31.8	33.2
Business equity	25.1	22.5
Other non-financial (mostly vehicles)	91.6	90.7
<p>* 1999: Note that 52.0% of HHs have at least one type of insurance, 6.2% have at least two types, 8% has three, 1% has four and 40.9% of HHs doesn't have at all.</p> <p>2002: Note that 56.9% of HHs have at least one type of insurance, 10.0% have at least two types, 5% has three, 4% has four and 43.1% of HHs doesn't have at all.</p> <p>Participation in retirement accounts figures for 1999 and 2002 are not directly comparable, as figures for 2002 include contributions to social security. See Table 2 for a breakdown.</p> <p>Sources: Cyprus figures based on the 1999 and 2002 Cyprus Survey of Consumer Finances.</p>		

Source: Antoniou G. et al. (2004).

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