

# Cyprus and the EU

The Road to Accession

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# 12 Cyprus in the EU: A Small State Perspective

RODERICK PACE

## Introduction

The accession of Cyprus in the EU has been analysed from many angles with a considerable amount of emphasis being placed on the likely effect of Cypriot accession on a solution of the Cyprus Problem. In this chapter the analysis shall focus on a number of other issues related to the Cypriot membership. The analytical approach in this chapter is based on a 'small state' perspective that seeks to establish whether small states have certain peculiar needs and how these can be met by EU membership. Therefore this chapter focuses on the position of small states in the EU and explores some potential avenues available to Cyprus as an EU member state.

When Cyprus joined the EU, on 1 May 2004, it did so in the company of nine other new member states, eight of which can be classified as small states. The EU is still in 'enlargement mode', meaning that eventually it could consist of at least 28 or more member states. The main characteristic of the EU both as it is and as it will be in the future if it grows further, is its heterogeneity in terms of the levels of economic development, political and legal systems, religions, languages, defence and foreign policy orientation. It is already a Union composed mainly of small states with a population of around 10 millions or less.<sup>1</sup> In this Union, Cyprus is only just above Luxembourg and Malta in terms of population, but equal to Luxembourg in all respects within the EU's institutions. Six of the 25 member states, namely Malta, Luxembourg, Cyprus, Slovenia, Estonia and Latvia can be defined as micro-states since each has a population of less than 2.5 millions while five namely Denmark, Ireland, Lithuania, Slovakia and Finland with populations ranging from little over 3.4 millions to 5 millions can be defined as very small states. Following these two bands there is the 'upper' group of small countries numbering seven in all, with populations ranging from just over 8 millions to around 11 millions and comprising Austria, Sweden, Hungary, Greece, Czech Republic, Belgium and Portugal.

This classification of small states by the population criterion alone shows that even among the class of small states there are marked differences.

The successful conclusion and ratification of the Nice Treaty cleared an important hurdle to enlargement, despite the criticism that was aimed at it because of its failures. The member states have concluded negotiations on a new European Constitution. The more difficult task of securing its ratification has begun.

From a Cypriot perspective, EU membership means that Cyprus has acquired unprecedented influence in the EU itself and, as shall shortly be argued, also in international affairs in general when compared to its non-member status. The same can be said of all new member states, especially those which together with Cyprus can be classified as micro-states.<sup>2</sup> As an EU member state and in accordance with the Nice Treaty, Cyprus will participate fully in the Council (where its weight in qualified majority voting has been fixed at 4 votes), it has the right to nominate a Commissioner, it has 6 seats in the EP, in the ESC and the Committee of the Regions. Cyprus has the right to nominate a Judge to the ECJ and another one to the CFI. Cyprus also appoints one member to the Court of Auditors. On the basis of the principle of 'digressive proportionality' and in common with all small member states Cyprus enjoys a slightly disproportionately bigger weight in the institutions than the larger member states. Indeed, the outcome of the Nice Treaty seems to be in line with the results that Cyprus had previously vaguely alluded to in the ideas it submitted to the Intergovernmental Conference 2000.<sup>3</sup> That said, however, it is deceptively easy to equate Cypriot influence in the EU with its weight in the institutions and thus ignore the broader implications of membership. Much more relevance may lie in the fact that as a member state, Cyprus will be involved in the legislative process from its initial stages and that Cypriot officials will participate in the complex administrative process usually referred to as 'comitology'. Moreover, the Cypriot parliament will also become more directly involved in the EU legislative process and will have to enhance its abilities to scrutinise and influence it. The main drawback in all this, and one which Cyprus shares with all small states, is the shortage of trained human resources to make its participation in the institutions as effective as it would want to. Participation in the institutions means that Cypriot policy stances will have to be taken seriously by fellow member states and that third countries will also begin to attach new importance to this island state precisely because of its position as a member of one of the world's largest markets and increasingly unified global political actor.

As a member state Cyprus has not reached the end of its adjustment to

the 'acquis communautaire'. This process, which began in around 1998 in preparation for the start of the membership negotiations and subsequently continued during the negotiations themselves, is not a process which will stop primarily because the acquis is evolving continuously. In addition Cyprus still has some adjustments to make gradually in line with the Act of Accession and above all one major important appointment to keep – which is that of joining the EU's Economic and Monetary Union (EMU) and eventually adopting the Euro at the appropriate time. This requires Cyprus to focus on the macroeconomic fundamentals and the so called 'Maastricht Convergence Criteria' (in so far as they continue in their present form) in order to achieve this aim. By no measure does the latter task promise to be easy or straight forward as was amply demonstrated in 2002 when the Cypriot rate of inflation increased slightly while the current account and the fiscal deficit deteriorated.<sup>4</sup> In addition it has still to grapple with the Cyprus' 'political problem' since the Annan Plan was rejected by the Greek Cypriots in a referendum, in April 2004. On the brighter side the Cypriot economy has shown in the past a resilience of its own and a capability of adjusting, often in the most seemingly unfavourable conditions.<sup>5</sup> Far from being an end in itself membership imposes adjustment burdens but also opens up new opportunities, which Cyprus can exploit to its benefit. This chapter will analyse some of the implications of EU membership for Cyprus from a small state perspective keeping in mind the following:

1. The special characteristics of Cyprus as a small island state on the periphery of the European Union and how the challenges posed by these characteristics can be addressed by EU membership;
2. The possible effect of EU membership on Cyprus's 'international position' and on the Cyprus Problem.

### **Small, peripheral, insular and divided**

Cyprus is a small state (population 865,300 including the Turks/Turkish Cypriots living in the northern occupied part), on Europe's periphery facing the turbulent region of the Middle East, an island with all the setbacks of insularity, but a strategic location. It is an island which is ethnically and forcefully divided with its capital Nicosia, the last divided capital of Europe. Together with Iceland and Malta it completes the team of Europe's only island micro-states. EU membership stands to reverse

most of the island's disadvantages:

- it can help Cyprus overcome its peripheral location by linking it to the heart of European politics;
- it allows Cyprus unrestricted access for its goods and services in the EU market thus enabling it to overcome the disadvantages of its restricted domestic market;
- it increases its political importance in international affairs and in the Middle Eastern region helping it to play a more important role in that sub-region;
- it enhances Cyprus's ability to play a pivotal role, possibly also to develop itself further into a regional economic hub in the Eastern Mediterranean; and
- finally EU membership may help bring to an end the forceful division of the island.

### **Broader market access or modernisation?**

Small states such as Cyprus with a small domestic market require access to large markets in order to sustain meaningful productive sectors of goods and services that can take advantage of economies of scale. Due to the lack of sufficient avenues to mobilise capital at home, and often the lack of know-how, economic growth is usually augmented by inflows of direct foreign investment (FDI). One of the main attractions to FDI is precisely free access to larger markets enjoyed by such small states and the availability of a trained labour force often in combination with some tax incentives.

This pattern of economic development exhibited by most successful small states also leads to more openness, to an increased dependence on the external environment and an increased vulnerability to the vicissitudes of the international economy particularly those resulting from the increased volatility of world financial markets and other international developments. The processes of globalisation and increased interdependence<sup>6</sup> and the impact of the progressive liberalisation and gradual integration of world markets as a result of the World Trade Organisation (WTO) and the communications revolution, has led to the further integration of all states in the world economy, not least among them the small states. Yet, at the same time, globalisation has increased competition in world markets, has led to a

marked power-shift towards transnational corporations and a further loss of policy autonomy by most states especially small states. In concert with others, mostly by joining regional groupings, small states can try to overcome the more negative effects of globalisation just described and to recover the powers lost by co-operating with other states.

In the face of these developments small countries have discovered that they have not been spared the need of adjusting to the new realities and challenges with what may be described as 'draconian' measures when compared to their individual small scale. These measures shook many of the old fundamentals and ushered in a new set of priorities in small states as well, which included privatisation, liberalisation of capital, goods and financial markets, liberalisation of telecommunications, standardisation, fiscal reform, social security and pension reform (welfare) and public sector reform. These reforms were accompanied by growing public pressure in favour of environmental and consumer protection – and more recently data protection – which led to the establishment of independent or semi-independent regulatory agencies to oversee the newly liberalised sectors in order to ensure fair play and the protection of the rights of consumers. In addition these demands have taxed the small states' limited reservoir (not of course measured on a per capita basis but in raw terms) of trained human resources and their administrative capabilities.

EU membership or as close a relationship to it as possible, offer small states a good vehicle for overcoming the main hurdles on the road to modernisation and above all of integration in the world economy in the least cumbersome manner. The *acquis* becomes the tried and tested 'off the shelf' available product, which – with some adjustments and modifications to take account of their smallness – shows them what has to be done to meet the various challenges they face saving them costly experimentation. EU membership offers small states improved access to Europe's internal market and opens the door to the markets of all the other countries linked to the EU by an association agreement or other form of preferential trading arrangement. In other words, it improves their access to the global market. This also makes them more open to imports with possible negative balance of trade effects. On the positive side openness helps small states keep inflationary pressures down and broadens consumer choice. Openness to imports also introduces more competition in the domestic market and helps to increase dynamic efficiencies with positive long term effects on export competitiveness in key sectors.

Indeed, a small state's integration in a larger regional group often develops in various phases in response to the transformations occurring on

the domestic front and the broader changes in the state's international environment. A glance at Cyprus's relations with the EU demonstrates this quite adequately as Cyprus progressed through the main three stages:

**Stage 1** In 1962 the EEC concluded an association agreement with Cyprus in the wake of the UK's membership application in order to help Cyprus preserve its main export markets. The main issue here was to secure an important life line for Cyprus still in its initial years of independence, grappling with the challenge of state-building and the consolidation of its independence.

**Stage 2** The 1973 Association agreement was also intended to maintain market access in the wake of the UK's EC membership but it was also intended to lead to the further diversification of Cypriot exports. This aim was temporarily thwarted by the 1974 invasion and division of the island but it was further strengthened by the EC-Cyprus customs union agreement of 1988.

**Stage 3** The main economic motivations behind the 1990 Cypriot membership application as stated in an official 1995 Cypriot Government publication were: eventual inclusion in the internal market characterised by the 'four freedoms', a secure climate, monetary stability, transfers from the Community budget to help Cypriot development, co-operation in technology transfer, research and development and training, in short modernisation.<sup>7</sup>

Thus, the evolution of Cyprus's relations with the EU demonstrates a fundamental transformation in the underlying basis of the relationship that also reflects the manner in which the EU itself has changed over time and the changing Cypriot priorities as Cyprus adapted to world changes. Initially, the emphasis lay on market access provided by the EC market. But as Cyprus moved up the development ladder the emphasis changed from mere market access to achieving the 'quality leap' that could be summarised under the concept of modernisation and integration in the global economy. From this perspective the opportunities provided by EU membership, if well and properly exploited, can better equip Cyprus to deal with the challenges of globalisation.

In its Regular Report on Cyprus's Progress Towards Accession of



November 2000,<sup>8</sup> the Commission stated, that the Cypriot economy was capable of meeting the competitive pressure and market forces within the Union. This broad positive appraisal of the Cypriot economy continues to hold as was clearly indicated in the last Commission Report on Cyprus published in November 2003.<sup>9</sup> However, growth slowed down in the last two years so that while real GDP growth averaged 4.6% per year for the years 1998-2001, in 2002 and 2003 this dropped to 2% per year.<sup>10</sup> The Commission's 2003 Report blames this decline on 'great geopolitical and economic uncertainty' which hit Cypriot exports and the tourist sector.<sup>11</sup> The former Minister of Finance, Markos Kyprianou summarised these uncertainties very succinctly: '...(stagnant) output in the main European trading partners and the threat of international terrorism compounding the negative effects on the exports of tourism services...'<sup>12</sup> The Cypriot authorities tried to ease the impact by adopting a more expansionary fiscal stance but coming at a time when cyclically-determined tax revenues were subdued while the costs of adopting the *acquis* were mounting, it forced Cyprus to slip from the Maastricht convergence criteria set for the achievement of European Monetary Union.

Structural reform in Cyprus has continued and this may have also contributed to the current difficulties. The recent decline in manufacturing and in the tourist sector underline the need to further diversify the economy towards new growth sectors. To accomplish this task, the Government has targeted telecoms, IT and business services and education. However, the Annual Economic Indicators published by the Central Bank in 2004 show that unemployment remains comparatively low at 3.5%. The danger is that expansion in the new growth sectors may lead to labour shortages. This problem could be addressed by 'importing labour', which would not be difficult now that Cyprus has joined the EU. Better still the 2003 Report advises Cyprus to enhance the flexibility of its labour force or to mobilise the potential labour force through education and training.

In the short-term these changes will undoubtedly result in adjustment costs for Cyprus. This is sometimes wrongly equated with EU membership when in fact other exogenous and endogenous factors often require the same sort of adjustment independently of membership. The fate of the Cypriot International Business and shipping sector illustrates the case.<sup>13</sup> Between 1976 and 1999 cumulatively a total of 41,752 'off-shore' business companies were set up in Cyprus of which around half are still active.<sup>14</sup> Latest estimates put the number of permits for the establishment of international business companies at around 57,000 and the number of expatriates and locals employed in the sector at 3,300 and 2,900 respectively.

Similarly, by 1999, cumulatively 12,187 permits had been issued to shipping companies to establish themselves in Cyprus. By 2002 there were 2,153 vessels totalling 24,860,060 GRT and making the Cypriot shipping register the sixth largest in the world. In addition a total of 30 foreign banks operate from Cyprus. In 1999, the country's total foreign exchange earnings in the sector (shipping and international business) amounted to CY£243.1 millions or 4.9% of GDP rising to CY£350 millions in 2003 or 5.3% of GDP. Pressure has been mounted on Cyprus, as has been on other off-shore havens, to end the special tax treatment of these 'off-shore' companies and to apply the OECD's guidelines against harmful tax competition. The Commission had stressed prior to membership that 'In the field of direct taxation the special regime for offshore companies needs to be addressed.'<sup>15</sup> It is for this reason that during the negotiations the chapter on taxation was one of those which took the longest to close. International Business Companies are taxed at only 4.25% of their profits and are totally exempted from corporation and income tax. There are also special advantageous tax treatment of expatriate employees and beneficial owners. At the same time Cyprus has had to enact and enforce stringent anti-money laundering legislation.<sup>16</sup> In the case of shipping the EU put pressure on Cyprus to increase ship safety and inspections in line with similar measures adopted at EU level.<sup>17</sup>

The International Business sector is an essential one for Cyprus helping the island diversify from overly relying on tourism. In the run up to membership Cyprus had to introduce more stringent supervisory legislation and laws to combat money laundering. But so far, though it is perhaps early to pronounce judgement on its fate, the sector seems to have held well and if the official figures are anything to go by, it has also expanded marginally. However, what is important to note in this case is that even outside the EU membership context, international pressure would have constrained Cyprus to tighten the laws governing this sector while adopting international norms help it strengthen its reputation in the world of international business.

### **The external dimension of Cyprus's membership: the Mediterranean region**

As has already been stated in this chapter, *ceteris paribus* the accession of Cyprus in the EU stands to enhance the importance of Cyprus in external relations especially in the Mediterranean and help maintain the EU's

interest in the region. The entry of Cyprus and Malta in the EU must be seen against the backdrop of the shift that has occurred in the EU's centre of gravity towards the countries of central and eastern Europe, resulting from the accession of 8 new states from that part of the Continent. This shift will become more accentuated in the future following the planned enlargement(s).

It must be noted that from its very beginning the EC/EU attached great importance to the maintenance of peace, stability and good neighbourly relations in the Mediterranean region. And for good reason too: many of the member states have a long Mediterranean coast line (France, Greece, Italy and Spain) as well as long-standing historic ties with the countries of the Mediterranean region. The Mediterranean region was the only one where from the very beginning the Community practiced an external policy, which in turn helped legitimise the EEC as a credible international actor. Today, the region is an important outlet for EU exports, not least for its northern member states.<sup>18</sup> Moreover, the Mediterranean region has developed into a strategically important conduit for the supply of a substantial part of the EU's oil and petroleum needs as well as a major world maritime highway for the transport of goods and oil.<sup>19</sup> Environmental degradation has a direct bearing on all states of region, not least among them the key member states.<sup>20</sup> A serious maritime disaster in this comparatively narrow sea<sup>21</sup> could have immediate negative economic effects on all states, especially those that have been expanding their income and employment from tourism. At the same time the expansion of the tourist sector is also increasing the environmental pressures in the region.<sup>22</sup> Sluggish economic growth combined with rapid demographic growth in some of the key southern countries, increases migratory pressures on Europe especially illegal emigration. In sum, negative developments in the Mediterranean region do not only affect the states of the region themselves, but they can also spillover onto the EU itself, sometimes with a knock on effect as well.

A serious military threat to Europe from the southern shore states of the Mediterranean region is most unlikely although the proliferation of weapons of mass destruction needs to be monitored closely. The decision by Libya, announced in December 2003, that it was dismantling its WMD programme was not only important as an initial step in bringing that country out of international isolation but it also strengthened hopes that more could be achieved on this front in the region. The southern Mediterranean countries probably attach more importance to the internal rather than the external threats to their security, while among the latter they mostly fear those coming from fellow southern neighbours rather than from

Europe.<sup>23</sup> To be honest, they are also suspicious of NATO's initiatives in the Mediterranean region.<sup>24</sup> In 1994 the Alliance started the 'Mediterranean Dialogue' with a number of countries of the region to begin to allay these fears and strengthen mutual understanding.<sup>25</sup> Since then the dialogue has matured further but it has not achieved spectacular results. NATO has also started revising its southern flank strategy and a RAND Corporation study commissioned by the Italian Ministry of Defence laid emphasis on the 'soft' security threats as being the main ones threatening the region's stability. This prognosis remained valid until the events of 11 September and the terrorist bombings in Casablanca, Istanbul and Madrid. Soft security threats emanate mainly from the instability that may accompany political upheaval and socio-economic pressures in the southern littoral countries.<sup>26</sup> North African states are critical of Europe's lack of engagement in the security problems of the region, a failure they perceive as one of the causes of the regional arms race.<sup>27</sup> Since 11 September 2001, a paradigm shift has also occurred in the region's security discourse with greater emphasis being placed on international terrorism. This shift was further reinforced by the terrorist attacks in Casablanca, Istanbul and Madrid. Many feared that the terrorist threat would be employed by the governments of the region to halt or reverse the small but important advances made on the human-rights democracy front. However international pressure did not relent at all on this issue. Two Arab Human Development Reports published by the UNDP in 2002 and 2003, a European Commission Communication on 'Reinvigorating EU Actions on Human Rights and Democratisation with Mediterranean Partners' (21 May 2004) and the support, even if somewhat mixed, given to political reform by leaders of the Arab League meeting in Tunis in May 2004 all underlined the resistance to abandoning political reforms in the southern shore countries. Arab governments and their Islamic fundamentalist opposition often find themselves in agreement when describing the West's insistence on political reform as a form of interference in their internal affairs.

Over the years the EC/EU has responded to the challenges it faces in the region by a series of policies, beginning with the Global Mediterranean Policy of the early 1970s and culminating in the Euro-Mediterranean Partnership, the so-called Barcelona Process, which began in 1995. In all these policies the EU sought to enhance stability in the region by acting as a civilian power. The EU's policies towards the region have periodically been criticised as being inadequate. A series of new EU foreign policy initiatives which started in 2003 have complicated matters further. In view of the forthcoming enlargement, the EU proposed a new 'Neighbourhood

Policy' which was followed in June 2004 by a proposal for a 'Strategic Partnership with the Mediterranean and Middle East'.<sup>28</sup> It is not clear how these initiatives will interface with one another and with the Euro-Mediterranean Partnership though it has often been claimed by the EU that these initiatives are all mutually enforcing and not mutually exclusive.

The main aim of the majority of these policies is undoubtedly the Union's own interests, though as a result of the criticism made by the southern Mediterranean shore countries the EU is becoming more sensitive to the idea of gradually engaging the southern shore countries in a true partnership. In the meantime, a broad assessment of the effects of these policies on the Mediterranean Basin countries reveals that indeed they have been instrumental at least in preserving the traditional trade outlets and market access for the southern littoral states and with laying the foundations for newer forms of co-operation across the region. The EC's preferential trading arrangements which have been in operation since the 1970s have also led to increases in the volume of trade between the EU and its partners. It is improbable that the region would have fared better without these agreements. The positive effects of the underlying cob-web of relations and networks that have been established as a result of these policies are already being felt and could possibly intensify in the future, if the Euro-Mediterranean Partnership is more successful. In September of 2000, the European Commission published new proposals on how the Mediterranean Partnership could be strengthened in the future.<sup>29</sup> These proposals formed the basis of discussions during the fourth ministerial meeting of the Euro-Mediterranean Partnership held in Marseilles on 15-16 November 2000.<sup>30</sup> Accordingly, the Euro-Mediterranean Partnership is still viewed by all the member states participating in it as the main instrument for enhancing stability in the region and the ministers encouraged the EU to take a more visible role in fostering dialogue, trust and confidence in the Middle East. This commitment to the Barcelona process was re-iterated at subsequent Foreign Ministers' meetings held in Valencia (2002), Naples (2003) and the Dublin mid-term Foreign Ministers' conference held in May 2004. The situation in the Middle continues to dictate the pace in the Euro-Mediterranean Partnership.

On the economic front the aim of achieving the Euro-Mediterranean free trade area by 2010 is still the main target. This has been helped by the conclusion of nearly all the bilateral free trade accords between the EU and the Mediterranean countries except with Syria which is in an advanced stage<sup>31</sup> and the launching of the Agadir Initiative involving Jordan, Egypt, Morocco and Tunisia in a south-south free trade area.<sup>32</sup> A common system

of rules of origin will eventually become operational after which the free movement of services and the removal of residual non-tariff barriers to trade could gain increased saliency. The major problem which has still to be resolved is the region's inability to attract sufficient flows of direct foreign investment (FDI). This is intimately linked to security perceptions about the region in the countries of origin and of course the lack of democracy, good governance and transparency as well as the absence of adequate laws regulating economic and business activities in the recipient states. However, the situation is not static either, but is improving across the region albeit at an uneven pace.

Following the EU's enlargement the main question bedevilling the minds of many in the southern littoral states is whether the Mediterranean Region will eventually be sidelined by a shift in the EU's internal and external priorities. On the internal front the main concern is the completion of the ratification process of the new European Constitution and the gradual assimilation of the new member states. In the external domain the main fear among the Mediterranean countries is that now that the centre of gravity of the EU has shifted eastwards, the Mediterranean region may be given less importance in the Union's priorities.

Enlargement has changed the nature of the Euro-Mediterranean Partnership from 15 EU member states plus 12 Mediterranean states to 25 plus 10 if Libya is also counted among the latter. The accession of the Mediterranean applicants Cyprus and Malta has further extended the EU's borders southwards in a very sensitive and turbulent region. In the EU itself the Mediterranean group presently composed of five member states, namely Spain and Portugal (even if the latter has only an Atlantic coastline), France, Italy and Greece will increase to seven. This does not entirely redress the geographic balance of the EU, which has clearly shifted eastwards. Hence, the EU will continue to maintain its interest in the Mediterranean region only if it perceives serious threats to its own security and stability emanating from it and if it can see that it has important gains to make by maintaining its focus and engagement in the region.

### **A possible role for Cyprus**

As two peripheral island states on the southernmost frontiers of the EU, Cyprus and Malta are both well positioned to be able to transmit the challenges and sensitivities of the region to the heart of the EU decision-making process. This is helped by the fact that small states tend to focus

more on their immediate environment than on the broader, global field. The down side of this is that they have to convince the larger member states that their concerns present real challenges to the whole of the EU. In some cases this is not difficult to achieve. For example the aftermath of 11 September 2001, the deteriorating situation in the Middle East and the invasion of Iraq in 2003, led to a marked downturn in air travel and the tourist industry. The effect on Cyprus and Malta was enormous given their dependence on the tourist service sector. The same can be said of the disruption and instability in the world oil markets instigated by the events in Iraq, the Middle East and the Arab Peninsula. In other words, whether it is terrorism, oil, tourism, or illegal immigration serious uncontrolled upheavals in the Mediterranean region tend to spill over onto the EU itself. The main difficulty for Cyprus is the ability to foresee situations developing into crisis or conflict situations. Small states do not have sufficient information-gathering means to foresee this happening and are more likely to react to situations which have developed and to situations which are still in the pre-crisis or pre-conflict stage.

In as much as Cyprus does not become overly engrossed with its own national question and the peaceful reunification of the island at the expense of a deeper participation in the EU's external policies, the framework of the Euro-Mediterranean Partnership offers unique opportunities for influencing policies towards the regional environment in which it has to survive. In the past, unable to influence events because of its smallness and limited resources Cyprus could only be the consumer of policies not their maker. As an EU member state it can participate in policy making at the highest levels. It can also employ the EU's Mediterranean policies towards achieving its own foreign policy goals. This will inevitably involve the Europeanisation of its national approaches towards the region. However, by working from within the EU's policies it can become more effective and achieve better results. Indeed, in addressing the 'natural' shortfall in its resources a small state like Cyprus can exploit is the bigger resources, regional and global contacts at the disposal of the EU to its advantage.

In addition, the status of Cyprus and Malta in the Euro-Mediterranean Partnership stands to be enhanced in other ways as a result of their EU membership. The EU exercises and has agenda-setting powers in the Partnership. Most policy initiatives begin with the Commission and are approved by the Council before they are transmitted to the Committee for the Barcelona Process and the Partners' governments. The EU also provides the bulk of the finance for the MEDA programmes, comprising both the multilateral and the bilateral initiatives and supporting networks.

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As a member state, Cyprus participates fully in the decision-making process of the EU and is in a position to influence policies in the design phase, giving it sufficient leeway to influence the shape of policies from their initial stages. This advantage is bound not to go unnoticed by the non-EU member states of the Euro-Mediterranean Partnership. Thus, it is likely that they will ascribe more relevance and importance to it than they did in the past.

One major drawback for Cyprus is that as a member state, it has to focus on a broader range of issues and policies whose direct relevance to the Mediterranean region might be minimal. Given that participation in the EU decision-making process places important constraints on a small state's comparatively more limited human resources Cyprus may at times lose its focus on the Mediterranean region. In addition this focus also depends on the importance that Cypriot political elites are willing to give it. However, it is important to keep in mind that broadly speaking, while the larger EU Mediterranean states, have multiple foreign policy interests and a divided attention (e.g. their priorities concern the Balkans, Central and Eastern Europe, the trans-Atlantic relationship, the Middle East and Far East) the main concerns of Cyprus are more focused on its immediate environment. This difference in perspective results primarily from Cyprus's smallness, vulnerability and insularity which cause it to focus more on issues of immediate relevance to it, which are in turn intimately connected with the situation in the Mediterranean region where it is situated.<sup>33</sup>

Indeed the stability of the Mediterranean region has a higher premium for Cyprus and Malta, and a relatively higher risk factor than for most other states mostly because the two island states are in the Mediterranean region and will be probably the first to be affected by any backwash of a crisis or conflict even when they are not directly involved in them. In order to illustrate the point better, the negative effects of the Gulf War are most instructive. In times of regional or international crisis small states' openness coupled with their vulnerability, which is rooted in economic specialisation (e.g. tourism), are much more threatening to their overall stability and social cohesion than is the case for large and more diversified economies. Thus, a serious political disturbance in the Mediterranean region and its environs or a maritime ecological disaster could affect negatively the economic well-being of Cyprus and Malta, where tourism contributes to more than a fifth of their respective Gross Domestic Product. Indeed, the evidence suggests that at the outbreak of the Gulf War in 1990 travel and trade in and across the region was negatively affected and both Cyprus and Malta claimed to have sustained losses.<sup>34</sup> The closure of the

Suez Canal following the 1967 'Six day war' is another example. This had a negative impact on Malta's key ship repair sector. The events of 11 September and the war in Iraq hit many of the world's airlines but they had a stronger effect on Cyprus and Malta by dampening their growth rates and exasperating their balance of payments.

It is also true, and paradoxically so, that some problems in the Mediterranean region could also lead to windfall profits, though this is not the general rule. One such 'windfall' occurred as a result of the war in the Balkans in 1999 by diverting some of the tourism that normally goes to that region to Cyprus.<sup>35</sup> Broadly speaking, while every Mediterranean Basin country reaps economic dividends from peace and stability, small and economically 'open' countries such as Cyprus and Malta stand to gain most from stability and risk losing most in the event of turmoil. Lastly, it can be shown from historic experience that the independence of small and weak states tends to be most at risk in times of conflict.<sup>36</sup> Thus while for most member states, the Mediterranean region may be 'another policy issue' with which they have to deal for a small country like Cyprus, an island in the midst of the region, the issue of Mediterranean stability is objectively the most important matter to which its survival is most intimately linked.

### **Concluding remarks: possible ways forward**

As has been argued above, the independence and identity of small states tends to be more at risk in an anarchical international or regional states system, especially in times of war, rather than in a 'rule-based' one. It is in the interest of Cyprus to strengthen regional stability and the Euro-Mediterranean Partnership serves this purpose very well. The Partnership can be compared to a rule-based international regime that suits Cyprus's interests in the Mediterranean region. The Partnership:

- facilitates the achievement of more open trade, eventually a Euro-Mediterranean free trade area
- strengthens the links of interdependence among the region's states and enhances regional stability
- potentially offers Cyprus a freer access to the markets of the Arab states
- provides a political forum for the discussion of some of the key

regional economic and political issues

- could facilitate confidence-building measures though no spectacular progress has been registered in this domain
- multiplies the horizontal and vertical links of co-operation across the region and keeps both sides of the Mediterranean Basin positively engaged in search of common solutions
- promotes a cultural dialogue which is also relevant to Cyprus's own internal situation but which is more important to the stability of the Mediterranean region
- serves as a means of consultation in times of political crisis in the region

In the final analysis it is a factor of stability for which there is no alternative substitute in sight. Hence it appears to be in Cyprus's interest not only to participate in it in order gain international influence and to be in a better position to attain its national aims through it, but also to strengthen its effectiveness. An ineffective EU Mediterranean Policy can theoretically be treated with indifference by most member states. An island state like Cyprus in the midst of the region simply cannot do the same.

What remains to be analysed are the possible policy avenues open to Cyprus as a member state. The optimal approach begins with recognising the sources of Cyprus's international influence in addition to its EU membership. Beginning first with its Commonwealth connections, together with two other member states, namely the UK and Malta, Cyprus has long standing relations with the countries linked to the EU by the Cotonou (former Lomé) Convention, apart from links with Canada, Australia, New Zealand and India to mention a few others. Cyprus is also a long-standing member of the Council of Europe, the Organisation for Security and Co-operation in Europe (OSCE) and a founder of the Non-Aligned Movement (NAM). The importance of the NAM has declined in the post-cold war setting, but the contacts and working relationships developed by Cyprus over the years may become useful now that it has joined the EU particularly since the states of the southern Mediterranean littoral are members of the NAM.

As a small country Cyprus still lacks enough means, diplomatic resources and critical mass to take a leading role in major problems and challenges (e.g. the Middle East or a crisis such as the Algerian one) which the EU faces in the Mediterranean region. However, Cyprus's role could become important in mobilising EU action. On the CSCE experience,

Cyprus could perhaps play the role of a messenger, an intermediary, a 'mellow', an initiator of third solutions, the provider of a constructive push in times of stalemate and a provider of good offices both in the EU and in the Euro-Mediterranean Partnership.<sup>37</sup> Cyprus can also become more effective by initiating policy initiatives that receive the support of the member states and of the Euro-Mediterranean Partnership. This task is not beyond the means of a small country as is illustrated by the many successful small country initiatives in the history of diplomacy. What they certainly require for success is a more sustained focus on the issues as well as investment in crucial resources required to establish them.

In such tasks, a small state can transform its small size into an asset rather than a handicap. It is recognised that due to its small size, Cyprus does not have the means to project power, it does not present a 'security dilemma' to its neighbours, except in a limited form for Turkey in the context of the Cyprus Problem, it does not have the means to pursue broader territorial or hegemonic ambitions. Furthermore, Cyprus shares a common history of colonialism with most of its southern neighbours, as a colony not a coloniser. Like them it has had a bitter-sweet experience of state-building and the post-colonial era. These credentials enable Cyprus to play the role of a trusted political 'broker' in the region. Cyprus has already had the opportunity of playing this role of a 'broker' during the Conference on Security and Co-operation in Europe (CSCE) together with the other members of the group of European Neutral and Non-Aligned countries (N + N).

A lot will also depend on the role which Cyprus will play in the EU's Common Foreign and Security Policy (CFSP) and the new European Policy on Defence. Cyprus claims that it is ready to take on the CFSP acquis. Its participation in the Petersberg tasks, which are consonant with the preferred policies of neutral and non-aligned states, is not expected to raise serious difficulties. Cypriot participation in the CFSP and the European Defence Policy will, however, enhance the island's credibility within the EU.

The last important aspect that has to be analysed concerns the advantages that Cyprus derives from EU membership and the free trade agreements that the EU has with the Mediterranean countries. Although the free trade agreements between the southern Mediterranean states themselves still lag behind, and the process of ratification of the bilateral accords is still taking place, nevertheless, the Euro-Mediterranean Partnership appears to be achieving its main goal of a free trade area by 2010. These agreements provide Cyprus freer access to the Arab markets

and possibly open up new export opportunities, particularly in the Middle East region with which Cyprus already enjoys strong trade links. In 1999 more than 17% of the value of Cypriot exports (domestic exports and re-exports) went to a number of neighbouring Arab countries and Israel.<sup>38</sup>

In conclusion it must be stated that for lack of resources, as a consequence of smallness, small states have to economise on those that are available to them and to optimise their employment. For a small state, the most expensive path to achieving its foreign policy goal is to pretend that it can work alone, that it can do everything 'in house' and nationally. EU membership provides small states with ready made policies, supported by adequate resources and with a critical mass that makes them globally and regionally effective and thus idea for small states to work from within them. A sea change has therefore occurred for Cyprus as an EU member state from one where it worked in relative isolation and self-reliance in a role of a consumer of foreign policy initiatives usually started by others to one where it forms part of a Union of states with growing importance on the world stage, where it could also join in policy making.

## Notes

1. Out of the 25 member states, seven member states, namely Germany, France, Italy, the UK, Spain, Poland and the Netherlands have a population size that is clearly above the approximation to ten millions mark.
2. Although the definition of a micro-state defined in population terms varies across the board, with 1.5 millions or less being the preferred cut-off point in many British Commonwealth publications, in the case of the EU this label can be applied without much controversy to Malta, Luxembourg, Cyprus, Latvia, Estonia and Slovenia.
3. *IGC 2000: Contribution from the Government of Cyprus*, CONFER/VAR 3951/00, Brussels, 24 February 2000.
4. 2003 Regular Report on progress towards Accession published by the Commission.
5. For example, the GDP per capita of Cyprus measured in Purchasing Power Standards in 2003 is just 17% below the EU-25 average. This puts Cyprus at the head of the pack of the EU's new member states and also ahead of Greece and Portugal which joined the EU in 1981 and 1986 respectively. See *Eurostat News Release*, STAT/04/73, 3 June 2004.
6. The terms interdependence and globalisation are being employed in the same manner as that of R.O Keohane and J. Nye in *Power and Interdependence*, Longman, 2001, 3rd edition, pp.229-230.

7. Republic of Cyprus, *Cyprus: The Way to Full EU Membership*, 3rd edition, Press and Information Office, 1995, p.10.
8. European Commission, *2000 Regular Report from the Commission on Cyprus's Progress Towards Accession*, Brussels, 8 November 2000.
9. European Commission, *Comprehensive Monitoring Report on Cyprus's Preparations for Membership*, November 2003.
10. Annual Economic Indicators, Central Bank of Cyprus, June 2004
11. *Comprehensive Monitoring Report 2003*, p.5.
12. Hon Markos Kyprianou, speech at the Joint Annual Discussion, World Bank, September 23-24, 2003, IMF Press Release, No 38.
13. The information in this section comes from data collected, courtesy of the Central Bank of Cyprus during a visit to the island in November 2000.
14. The November 2000 Regular Report by the Commission on Cyprus's Progress towards Accession (p.59) it is claimed that there are 42,000 registered offshore companies in Cyprus. But this figure is disputed by a Central Bank of Cyprus official who claims that only around half of these companies are actually active.
15. *Ibid.*, *Commission Regular Report on Cyprus's Progress towards Accession*, November 2000, p.59.
16. *The Prevention and Suppression of Money Laundering Activities Law of 1996*.
17. *Ibid.*, European Commission, *Commission Regular Report on Cyprus's Progress towards Accession*, November 2000, p.55.
18. In 1999, exports by the EU 15 to the Mediterranean Basin countries amounted to €87.8 billions (11.6%) of total extra-EU exports of the EU, while imports amounted to €63 billions (8.2%) of all extra-EU imports. In 1999, the main EU exporters to the Mediterranean Basin countries were Germany 22%, France 20% and Italy 18%. Source: Eurostatistics, *Data for Short-Term Economic Analysis*. Theme 1, General Statistics, (Monthly), European Commission.
19. It is estimated that 30% of total merchant shipping in the world and 20% of oil shipping cross the Mediterranean each year. See, '*State and Pressures of the Marine Coastal Mediterranean Environment*', European Environment Agency and UNEP, Office for Official Publications of the European Communities, 1999, pp.66-70.
20. See for example the *Dobris Assessment on the Mediterranean*: D. Stanners and P. Bordeau (eds.) '*Europe's Environment: The Dobris Assessment*', European Environment Agency, Copenhagen, 1995, pp.116-121
21. On average there are 60 maritime accidents per annum in the Mediterranean region, with about 15 involving ships causing oil and chemical spills. [*ibid.*, *op.cit.*, UNEP and EEA 1999, page 66]. According to the second assessment of Europe's Environment, carried out by the European Environmental Agency, there are about 40 oil related sites in the Mediterranean region (pipeline terminals, refineries, off-shore platforms etc) and an estimated 0.55

and 0.15 billion tonnes of crude oil and petroleum products respectively are loaded and unloaded every year. See *'Europe's Environment: The Second Assessment'*, European Environment Agency, Office for Official Publications of the European Communities, 1998, page 220.

21. For a discussion of the environmental effects of tourism on the region see *ibid.*, pp.49-52.
23. F. Faria and A. Vasconcelos, 'Security in Northern Africa: Ambiguity and Reality', *Chaillot Papers*, No.25, September 1996, p.4.
24. *Ibid.*, p.11.
25. The six non-NATO Mediterranean partners are Egypt, Israel, Jordan, Mauritania, Morocco and Tunisia.
26. N. De Santis, 'The Future of Nato's Mediterranean Initiative', *NATO Review*, 1, spring 1998, pp.32-35.
27. G. Joffe, 'Southern Attitudes Towards an Integrated Mediterranean Region', *Mediterranean Politics*, Vol.2, No.1, summer 1997, p.18.
28. *EU Strategic Partnership with the Mediterranean and the Middle East - Final Report*, published in *Euromed Report*, No.78, 23 June 2004, European Commission.
29. *'Reinvigorating the Barcelona Process'*, COM(00) 497 final, Brussels, 6 September 2000.
30. Press Release, Press 439, No.13434/00, Council of the EU, Brussels 16 November 2000.
31. These bilateral Association Agreements have been concluded with all countries and are at various stages of ratification. The Agreement with Syria has been concluded at a technical level and awaits signature and ratification. With Libya there is no agreement as this country was a late comer to the process and for the moment it still has observer status.
32. The EU is supporting this free trade area initiative which is an important step forward in the achievement of a Euro-Mediterranean Free Trade Area by 2010 and as such it falls within the aims of the Barcelona Process. External Relations Commissioner, Chris Patten attended the signing of the agreement which took place in Agadir on 25 February 2004. Patten stated: 'This agreement brings us closer to our joint objective of a Mediterranean Free Trade Area by 2010' The Agadir Initiative is open to all other Arab countries who wish to join it.
33. The argument used here with respect to the European states can be used with equal force to the 'multiple' foreign policy interests of the Arab states of the region: e.g. Arab politics, African politics etc.
34. The Central Bank of Cyprus had this to say: 'Economic activity during the first quarter of 1991 suffered a severe blow from the eruption of the Gulf war...Tourism and related activities, which are highly vulnerable under conditions of political and military turmoil, experienced substantial losses arising from a greatly reduced tourist inflow. The setback...was enhanced by an expansion of the trade deficit... [resulting] from reduced foreign demand

for manufactured goods , particularly in the Arab countries and the Middle East...’, *The Bulletin*, Central Bank of Cyprus, June 1991, No.111, p.1. This is what the Maltese government had to say about the Gulf crisis: ‘One of the main factors behind this development (slow down in foreign demand) is the slowdown observed in the export of services, particularly tourism, associated with the adverse repercussions of the Gulf crisis on the economy during the first part of the year.’ *The Economic Survey January-September 1991*, Ministry of Economic Affairs Malta, p.23

35. Cyprus, IMF Staff Country Report No.00/123, September 2000, p.6.
36. Morgenthau puts it quite eloquently: ‘At the end of the thirty Years’ War, for instance, the German Empire was composed of 900 sovereign states which the Treaty of Westphalia in 1648 reduced to 355. The Napoleonic interventions...eliminated more than 200 of the German sovereign states. When the Germanic confederation was founded in 1815, only 36 sovereign states were left to join it. The unification of Italy, in 1859, eliminated seven sovereign states, the unification of Germany in 1871, twenty-four...’ H.J. Morgenthau, *Politics Among Nations*, 6th edition, Alfred A. Knopf, 1985, pp. 360-362.
37. This is the role that the N+N group played in the CSCE according to A. Bebler in ‘The NN Group in the New European Security Architecture’, *The International Spectator*, IAI, Rome, Volume XXVII, No 1, January-March, 1992, p.72.
38. According to figures published in *The Quarterly Economic Review*, Central Bank of Cyprus, June 2000, p.80. The Arab countries referred to here are Lebanon, Syria, Egypt, Saudi Arabia, Kuwait and Iraq.