Building the Legal Framework of Privatizations in Cyprus: The Missing Link with Sustainable Development

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Abstract

This article presents and scrutinizes the Privatizations Law of the Republic of Cyprus, in the context of sustainable development. Cyprus was another victim of the Eurozone crisis. A bailout agreement was reached between Cyprus and its creditors. This bailout agreement was accompanied by a Memorandum of Understanding (MoU) on specific Economic Policy Conditionality requiring certain reforms. The Cyprus MoU required, among others, privatizations of certain State-owned enterprises. In 2014, Cyprus adopted the Privatizations Law stipulating the details of the privatization process. This article presents and discusses the most important aspects of this Law. A critical overview of the legal framework of privatizations is provided in the context of sustainable development. The contribution of this privatization procedure to sustainable development is examined. More specifically, the absence of sustainable development from the Privatizations Law is criticized. This article sheds light on the relationship between the privatized enterprises and sustainable development. Certain proposals in the light of the golden shares case law of the Court of Justice of the EU (CJEU) are made. It is argued that sustainable development could be pursued through golden shares in privatized enterprises. Proposals for the inclusion of Corporate Social Responsibility (CSR) in privatized enterprises are brought forward. This article also considers various challenges to the privatization programme of Cyprus.

1. Introduction

The economy of the Republic of Cyprus was hit by the Eurozone crisis. Serious financial and structural problems of its banking sector and excessive public deficits thrown Cyprus economy into turmoil. In March 2013, the Cyprus government reached a bailout deal with the Eurogroup, the European Commission, the European Central Bank (ECB) and the International Monetary Fund (IMF) (the so-called “Troika”).

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A Memorandum of Understanding on Specific Economic Policy Conditionality (MoU) accompanied this 10 Billion Euros bailout deal.\textsuperscript{2} The Cyprus government had to proceed to certain financial, fiscal and structural reforms, according to this bailout agreement. Cyprus had to reform its banking sector due to the collapse of the biggest banks of the island. It had to restructure and downsize its financial institutions, to strengthen banking and financial supervision and to address expected capital shortfalls. The fiscal reforms demanded from Cyprus to continue the on-going process of fiscal consolidation in order to correct the excessive general government deficit as soon as possible. Among the essential reforms for fiscal consolidation was the improvement of the functioning of the public sector. With regard to structural objectives of the MoU, Cyprus had to implement structural reforms to support competitiveness and sustainable and balanced growth. Cyprus had to allow for the unwinding of macroeconomic imbalances, especially by reforming the wage indexation system and removing obstacles to the smoother and more efficient functioning of services markets.\textsuperscript{3} Privatizations of State-owned enterprises (the so called “semi-governmental organizations”) fell within the scope of the fiscal and structural reforms mentioned above. The improvement of the functioning of the public sector included the privatization of certain State-owned enterprises. The State-owned enterprises which would not be privatized had to improve their efficiency and to be re-organized.\textsuperscript{4} Regarding the goals of structural reforms, special emphasis is given on sustainability through sustainable and balanced growth.

A comment on the legal status of State-owned enterprises should be made at this point. Cyprus\textsuperscript{5} has many State-owned enterprises, the so-called “semi-governmental organizations”/ “semi-public enterprises”. These State-owned enterprises are public entities / legal persons governed by public law.\textsuperscript{6} They are not legal persons of

\textsuperscript{2} According to paragraph (G) of the Financial Assistance Facility Agreement between the European Stability Mechanism and the Republic of Cyprus as the beneficiary Member State and Central Bank of Cyprus as Central Bank, a Memorandum of Understanding was entered into between the European Commission (on behalf of the ESM and with the approval of its Board of Governors) and the Republic of Cyprus. The financial assistance to be provided to the Beneficiary Member State under this Agreement shall be dependent upon compliance by Cyprus with the measures set out in the Memorandum of Understanding. Financial Assistance Facility Agreement between European Stability Mechanism and the Republic of Cyprus as the Beneficiary Member State and Central Bank of Cyprus as Central Bank (2013), pp 2.

\textsuperscript{3} Memorandum of Understanding on Specific Economic Policy Conditionality (MoU) (April 2013) pp 1.


\textsuperscript{5} It should be noted that Cyprus is a mixed legal system: N Hatzimihail, Cyprus as a Mixed Legal System 6 Journal of Civil Law Studies 37-96 (2013), SS Symeonides, The Mixed Legal System of the Republic of Cyprus 78 Tulane Law Review 441 (2003).

\textsuperscript{6} O Jastrebov, The Use of the Category of “Legal Persons of Public Law” in Foreign Legal Instru-
private law, for example companies.\textsuperscript{7} As a matter of fact, they are governed by public law. Some general characteristics of these enterprises are that they are State-owned and controlled, are active in business activities and are aiming at sociopolitical goals together with the primary economic goals.\textsuperscript{8} In this article, the terms State-owned enterprise, State-owned company, privatized enterprise and privatized company would be used.

2. Requirements of the MoU: State-owned Enterprises and Privatization

2.1. Privatizations in the Context of Economic Problems

As mentioned above, the economic problems confronted by Cyprus were threefold: financial, fiscal and structural.\textsuperscript{9} The Cyprus MoU required certain fiscal-structural measures: “Looking ahead, if the public sector is to provide appropriate support for the sustainable and balanced growth of the Cyprus economy, fiscal-structural reform steps are needed to ensure the long-term sustainability of public finances, to provide the fiscal space necessary to support the diversification of the economy, and to alleviate the adverse impact on jobs and growth arising from Cyprus’ exposure to external shocks”. Among the objectives set for the implementation of these fiscal-structural measures, the Cyprus government should seek to improve the efficiency of State-owned enterprises/semi-governmental organizations and to launch a privatization programme of these enterprises.\textsuperscript{10}

The Cyprus government agreed with its international creditors, the Troika (European Commission, European Central Bank and International Monetary Fund), to

\textsuperscript{7} For State-market and public-private dichotomies, see: J Clifton, F Comín and D Díaz Fuentes, Privatisation in the European Union. Public Enterprises and Integration, 7-13 (Dordrecht, Springer, 2003). A corporatization process is necessary before privatization.

\textsuperscript{8} Y Kumar Sharma, Globalisation, Privatisation and Market Economy, 10 (Jaipur, India, Aavishkar Publishers 2007).


proceed to certain privatizations of State-owned enterprises. The Cyprus MoU specified certain requirements for the privatization of State-owned enterprises.

2.2. Preparing the Ground for Privatizations

Initially, the Cyprus government had to proceed to some preparatory acts in order to prepare the ground for the privatization plan. It had to draft an inventory of all assets owned by the State: State-owned enterprises, real estate and land. This inventory included ownership by central government, municipalities and regional administrations. The Cyprus government agreed to give priority to assets with the highest commercial value, including at least one third of State-owned enterprises. Moreover, this inventory would clarify which State-owned enterprises would be subject to divestment or restructuring or liquidation. The Cyprus MoU emphasized that the largest and most valuable real estate and land assets must be included. The inventory then would be submitted to the Troika.\footnote{Memorandum of Understanding on Specific Economic Policy Conditionality (MoU) (April 2013) pp 19.}

Another preparatory act is related with the amelioration and enhancement of the governance and management of State-owned enterprises. The Cyprus MoU requires the preparation of a plan to reinforce the governance of State-owned enterprises in accordance with international best practices and to draft a report reviewing the operations and finances of State-owned enterprises. According to the MoU, this report would evaluate these companies’ business perspectives, the potential exposure of the government to the State-owned enterprises and the range for orderly privatization. The Cyprus government was bound to adopt the essential legal framework for the fulfillment of this requirement. Additionally, Cyprus would not establish any new State-owned enterprises throughout the duration of the Economic Adjustment Programme of the bailout.\footnote{Ibid., pp 19.} Moreover, the MoU also stated that: the Cyprus government had to “submit to the House of Representatives a draft law to regulate the creation and the functioning of State-owned enterprises at the central and local levels and enhance the monitoring powers of the central administration, including reporting on State-owned enterprises in the context of the annual budgetary procedure”.\footnote{Ibid., pp 19.}

2.3. The Privatization Plan

Cyprus had to launch an ambitious privatization plan. According to the MoU, the aims of this privatization plan was improvement of economic efficiency through enhanced competition and encouragement of capital inflows and restoration of debt sustainability. The privatization plan would consider the perspectives on privatization of State-owned enterprises/semi-governmental organizations. The most important State-owned enterprises of Cyprus which were included into this privatization plan

\footnote{Memorandum of Understanding on Specific Economic Policy Conditionality (MoU) (April 2013) pp 19.}
\footnote{Ibid., pp 19.}
\footnote{Ibid., pp 19.}
were CyTA (telecommunications), EAC (electricity), CPA (ports), as well as real estate/land assets.15

Some of these State-owned enterprises constitute natural monopolies.16 The privatization of these natural monopolies should not endanger the provision of these vital public services. These privatizations should take place in parallel with the adoption of rules safeguarding these public services. Hence, an appropriate regulatory framework securing the provision of public services must be adopted, as a prerequisite of the privatization process. The MoU demanded clearly that the provision of basic public goods and services by privatized industries would be fully safeguarded. This regulatory framework must comply with the national policy goals and with primary and secondary EU Law.17

The privatization plan was subjected to specific requirements and set certain financial goals. According to the MoU, the requirements of the privatization plan included: 1) the privatization plan would be based on the report reviewing the operations and finances of State-owned enterprises, as well as the inventory of assets and, 2) the privatization plan would be created after consultation with the Troika, including asset-specific timelines and intermediate steps, 3) the specific legal and institutional framework for the privatization process would be drafted and implemented, after consultation with the Troika.18 The financial goal that the MoU set for the privatization plan was that the privatization plan established by the Cyprus Government after consultation with the Troika would raise at least 1 billion Euros by the end of the Economic Adjustment Programme period and an additional 400 million Euros by 2018 at the latest.19

Moreover, the evaluation and restructuring of the State-owned enterprises constitute part of public administration reform required by the MoU. The Cyprus government must commission an independent external review of possible further reforms of the public administration, which would examine, among others, the possibility of abolishing or merging/consolidating non-profit organizations/companies and State-

14 The Decree for privatization of EAC (Electricity) was withdrawn on 22 January 2016 (ΚΔΠ 176/2014).
17 Art. 106 (2) TFEU states: “Undertakings entrusted with the operation of services of general economic interest or having the character of a revenue-producing monopoly shall be subject to the rules contained in the Treaties, in particular to the rules on competition, in so far as the application of such rules does not obstruct the performance, in law or in fact, of the particular tasks assigned to them. The development of trade must not be affected to such an extent as would be contrary to the interests of the Union.” Memorandum of Understanding on Specific Economic Policy Conditionality (MoU) (April 2013) pp 20.
19 Ibid., pp 20.
owned enterprises. Hence, privatization is not the only available route for State-owned enterprises of Cyprus. Mergers, consolidations, restructuring and even abolishments of State-owned enterprises could take place. The government has many available tools for restructuring and making more efficient and productive these State-owned enterprises. Abolishment of State-owned enterprises is a last resort measure, due to the high political cost (collective redundancies or transfer of these employees to other services, withdrawal of the State from a specific part of the market etc.). Hence, not all State-owned enterprises had to be privatized, but some of them. The remaining State-owned enterprises, which would not be part of the privatization programme, had to be re-organized and restructured in order to become more efficient.

2.4. Privatizations as a Vehicle For Investments

Privatizations were also considered a method of attracting foreign investment to Cyprus. Cyprus law offers an adequate and satisfactory level of legal protection to foreign investors. This protection is provided by international investment law, the Constitution of Cyprus and domestic law, European Union Law and the multilateral and bilateral Treaties concluded by Cyprus. The right to property is protected under Art. 23 of the Constitution of Cyprus, which corresponds to Art. 1 of the First Protocol to the European Convention for the Protection of Human Rights and Fundamental Freedoms (ECHR). Foreign investors who invested in movable or immovable property in Cyprus (such as foreign investors participated in a privatization) enjoy on an equal terms all rights of this property, which are also available to Cyprus nationals, and could get the same legal protection in case of their violation. The Constitution of Cyprus does not define the right to property; in case Evlogimenos and others v. The Republic of Cyprus, the Supreme Constitutional Court of Cyprus interpreted this right and found that it is not a right in abstracto, but a right defined and regulated by civil law.

Cyprus signed and ratified two multilateral treaties aiming at the protection of foreign investment: the Convention Establishing the Multilateral Investment Guar-
antee Agency (MIGA) and the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (the ICSID Convention). Moreover, Cyprus has signed many bilateral treaties for the promotion and reciprocal protection of investments, as well as many double tax agreements. Cyprus is expected to attract many investors, who are going to participate in the privatization of State owned enterprises. The main reasons making Cyprus a popular destination for investments are its strategic location, its membership in the EU and in the Eurozone, its tax system, its legal and regulatory framework, human resources and quality of professional services, advanced infrastructure, high quality of life and economic prospects and opportunities.

3. Institutional Structure of the Privatization Process

3.1. Bodies Involved in the Privatization Process

Law 28(I) of 2014 regarding the Regulation of Issues of Privatizations (hereinafter “Privatizations Law”) was adopted on 4 March 2014 and established the legal framework of privatizations in Cyprus. Privatizations Law founded the procedural framework of privatizations in Cyprus (Art. 3 of Privatizations Law). This law aimed at balancing the political decisions for privatizations with certain procedural safeguards. It also delimited clearly the powers of various bodies involved in the privatization process. Cyprus chose framework legislation instead of case-by-case legislation.

The Privatizations Law determines the bodies which would be responsible and would take the essential decisions for the privatization process. The Privatizations Law determines the competences of each body. The Council of Ministers and House of Representatives play a very important role, as they would be the ultimate adjudicating...
tors of privatizations of specific State-owned enterprises. These political bodies would take the decisions whether a specific State-owned enterprise would be privatized and how the privatization would take place. It is obvious that the role of politicians would be crucial in the privatization process. This decisive role bestowed upon the executive and the legislature managed to alleviate societal reactions to privatizations and concerns of employees of State-owned enterprises about their future employment status. It would be interesting to see the involvement in practice of the various bodies in the privatization process.

The Council of Ministers is responsible for the overall guidance and approval of the privatizations taking place at the Republic of Cyprus. The Council of Ministers decides which assets should be privatized, supervises the privatization process and provides approvals for all major stages of the relevant process. This also encompasses the approval of the final agreement with the potential investor, subject to an overall approval by the House of Representatives (Art. 6 of Privatizations Law). The House of Representatives plays a major role in the privatization process. The legislative proposals for privatizations of each State-owned enterprise, which are approved by the Council of Ministers, are submitted to the House of Representatives. These legislative proposals need to be enacted into law by the House of Representatives. Furthermore, at the final stage, the Council of Ministers, must submit a set of regulations for these privatizations to the House of Representatives for approval by a law, concerning the final stage of privatization, including the deal with the investor. The Privatizations Law introduces also some consultative and technical bodies, which support the lawmaking process. More specifically, an Interministerial Committee, a Privatization Unit and Technical Committees are introduced. The Privatizations Law establishes an Interministerial Committee. This Interministerial Committee aims at facilitating the work of the Council of Ministers. It is composed of the Minister of Finance (chair), Minister of Transport, Communications and Works, Minister of Energy, Commerce, Industry and Tourism and Minister of Labour, Welfare and Social Insurance. This committee does not have any decisive powers. It plays a consultative role; it scrutinizes issues in relation to the privatizations and assesses recommendations from the Privatizations Unit, before these are submitted to the Council of Ministers for approval (Art. 7 of Privatizations Law). The Interministerial Committee ensures political consent at governmental level on the thorny issues of privatizations.

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34 This corresponds to the separation of powers into a legislature, an executive, and a judiciary. For an analysis of the constitutional framework of the Republic of Cyprus, where these bodies are established and operate, see: AC Emilianides, *Constitutional Law in Cyprus* (Hague, Kluwer, 2013), C Melides, *Constitutional Law* in A Neocleous (ed.) *Introduction to Cyprus Law*, 45-85 (3rd Edition, Limassol Cyprus, Andreas Neocleous & Co LLC, 2010).


before such issues are presented in the Council of Ministers and in the House of Representatives.

There is also a completely new body, the Privatization Unit. The Privatizations Law stipulates that the Privatization Unit has the overall responsibility for administering the procedures of the Privatization Programme. The Privatization Unit examines carefully the requirements for the privatization of every State-owned enterprise. Then, it makes suggestions regarding the various stages of the transaction for approval by the Council of Ministers (Arts. 8, 11, 14 of Privatizations Law). The Privatization Unit is directed by its Head, the Commissioner for Privatizations, who is responsible for the operation of the Unit (Arts. 9-10, 12, 14 of Privatizations Law).38

Additionally, Technical Committees provide technical support to the privatization process. According to the Privatizations Law, there is going to be a Technical Committee for the privatization of each State-owned enterprise. These Committees will perform specialized tasks regarding each privatization and their role requires close cooperation and coordination with the Commissioner for Privatizations. Each of the State-owned enterprises under privatization presents various peculiarities in relationship with the services and the public interest39 entrusted to each of them. Hence, the Technical Committees will provide information on complicated technical matters in relationship with the activities of these State-owned enterprises under privatization (Arts. 18-19 of Privatizations Law).40

3.2. Various Aspects of the Privatization Process

The Cyprus legislature was concerned with employee protection during the adoption of the Privatizations Law. The first stage of the privatization process includes consultation and exchange of information between the Interministerial Committee and the representatives of the employees regarding their rights and benefits on the basis of national and EU law.41 The priority that the Cyprus legislature gives to employee protection contributes to sustainability. Quite often, employee protection issues arise during the privatization process, which could obstruct the completion of the privatization through collective action. The Cyprus legislature predicted this possibility. This provision was adopted due to political reactions concerning the future employment status of employees of State-owned enterprises under privatization.42

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38 Ibid., pp 1.
39 According to the OECD Guidelines on Corporate Governance of State-Owned Enterprises: “The state exercises the ownership of SOEs in the interest of the general public. It should carefully evaluate and disclose the objectives that justify state ownership and subject these to a recurrent review.” OECD Guidelines on Corporate Governance of State-Owned Enterprises, pp 17, 29.
41 Ibid., pp 1-2.
42 The German government invoked the protection of workers in order to justify its golden shares, but this justification was not accepted the CJEU. Case C-112/05 Commission v. Germany [2007] ECR I-8995 paras 72-76.
Next, the Council of Minister decides the privatization method that would be followed for each State-owned enterprise under privatization. It also ensures all issues of national security. Certain sectors could be excluded from privatizations, if this is deemed necessary for the national security of Cyprus. The liabilities of these State-owned enterprises would be settled before their privatization. At this point, compliance with EU state aid rules is required. Moreover, any Cyprus laws on establishment, operation, local or international obligations and rights of the staff of the State-owned enterprises must be amended or be repealed. Furthermore, a legal framework for the regulation of monopolies must be adopted. This legal framework must be structured in compliance with EU competition law. Additionally, the House of Representatives plays a crucial role in the procedure of privatizations. More specifically, the House of Representatives must approve the regulations on the time of commencement of the privatizations, the assets to be privatized, the procedure and the amount of the consideration (Art. 5 of Privatizations Law).

The Privatizations Law allows all methods of privatization, that are used in business environment, such as sale, lease, grant of operational rights, etc (Art. 4 of Privatizations Law). The Privatizations Law adopts a quite flexible approach and allows the combination of more than one method in the context of a single privatization.

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44 See, Arts. 107-109 TFEU.


47 Summary of the Key Provisions of the Law on Privatisation, Ministry of Finance of the Republic of Cyprus, (2014), pp 2. An interesting enumeration of the various methods of privatization is provided by Vickers and V Wright: • abolishing or severely curtailing public services on the assumption that private provision will fill the gap; • squeezing the financial resources of publicly-funded bodies in the hope of inducing them to seek compensating private funding; • increasing the financial contribution of consumers for public goods-a policy partly inspired by the desire of reduce the role of the State as purchaser; • encouraging the private sector to share in public investment projects: a policy long practised in countries such as France and Belgium through the sociétés d’économie mixte; • promoting joint public/private (often foreign) production ventures; • transferring to the private sector public policy responsibilities; • encouraging private finance to build and operate public works; • introducing private sector personnel and notions of efficiency and of management techniques into the public sector in the hope of imparting a greater ‘commercial orientation’ into its ethos and functioning; • facilitating private sector competition with the public sector by a policy of liberalisation and deregulation. There has been, in several European countries, some relaxation of statutory State monopolies or licensing systems. • contracting out public services to private agents; • selling land and publicly-owned housing stock.” J Vickers and V Wright ‘The politics of industrial privatisation in Western Europe: an overview’ in J Vickers and V Wright (eds.) The Politics of Privatisation in Western Europe (London, Frank Cass, 1989) pp 3. For a consideration of mixed public-private arrangements, see: JW van de Gronden, The
Special emphasis should be given to industrial privatization, a very popular method of privatization. From a company law point of view, industrial privatization presents a great interest. Industrial privatization, broadly speaking, concerns sale of public industrial assets to private individuals or groups. This method of privatization encompasses the sale of subsidiaries belonging to nationalized industries, the recapitalization of public companies by allowing the participation of private investors, the sale of a proportion of the shares in firms which the State owned or in which it had a holding, not necessarily a majority, and the outright sale of public firms to private investors. Privatizations do not concern only State-owned enterprises. Immovable property of commercial value, which belongs to Cyprus government, could also be sold or leased to private investors. Additionally, licensing of certain business activities (e.g. casinos/lotteries) falls within the scope of privatizations.

There is also a requirement of prior consultation for the Board of Directors of the State-owned enterprise under privatization. The Board of Directors of such enterprise must consult with the Privatization Unit and the Interministerial Committee, before applying the decisions, in cases of major decisions, including capital investments, incurrence of liabilities beyond the ordinary course of business, affecting directly or indirectly the value of the State-owned enterprise under privatization (Art. 23 of Privatizations Law). A decrease in the value of the State-owned enterprise might affect severely the perspectives on privatization, as it might deter potential investors.

The privatization scheme was initiated due to budgetary needs arisen from the financial crisis. The Privatizations Law specifies that all proceeds received from the privatization of State-owned enterprises would be deposited to the central consolidated fund of the government and would be used for the reduction of the public debt, which was one of the main factors of the Cyprus financial crisis (Art. 20 of Privatizations Law). This contribution on behalf of the privatizations would assist in making the public debt financially sustainable. The Privatizations Law has also some other provisions on conflict of interest (Art. 13 of Privatizations Law), monitoring mechanisms, auditing procedures (Art. 21 of Privatizations Law), confidentiality (Art. 16 of Privatizations Law) and transparency issues (Art. 17 of Privatizations Law), offences (Art. 22 of Privatizations Law) etc.

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3.3. Absence of Sustainable Development from Privatizations Law

Sustainable development\(^{51}\) should also be a part of the privatization process. During the divestment of its shareholding, the State could pursue sustainability. The acquirers of State shareholding, the new shareholders, should get bound to pursue sustainable development. For the attainment of sustainable development goals by the new shareholders of the privatized enterprise, certain bold proposals could be brought forward. Sustainability could be pursued during the selection of the new shareholders and during the transfer of the shares to the new shareholder. First, the State should impose certain sustainability standards, which the private investor planning to acquire the shareholding of the State should comply with. Only investors which fulfill these sustainability standards might be able to acquire part or all the shareholding of the State. Secondly, the State could impose certain obligations to pursue sustainable development on the privatized enterprise during the transfer of the shares to the new shareholders. State should ask the new shareholders acquiring the shareholding of the State to agree to some sustainability requirements, which must be added to the agreement. Hence, the agreement could contain certain terms obliging the new shareholders to comply with certain sustainability requirements after the transfer of the shares, and as a matter of fact, of the corporate control. As a result, promotion of sustainability could take place through certain obligations, which the new shareholders should bear on the basis of the agreement.

Above, an overview of the Cyprus privatization framework was provided. In this privatization framework, there was no reference to sustainable development. In the legal framework stipulating the privatization process of Cyprus, there was no reference to sustainability. In the provisions describing the institutional framework of the privatization (the organs, their roles, etc.), as well as the procedural framework of the privatization (the various stages that must be followed), sustainable development is absent. This is a quite important deficit of this legal framework. Although the Cyprus MoU refers to sustainable and balanced growth, the Privatizations Law does not refer to sustainable development. Privatizations were something new for Cyprus. Therefore, this was an excellent opportunity to create a legal framework of privatizations in line with sustainable development. Unfortunately, this did not happen. The new shareholders, which will acquire the corporate control of the privatized enterprises, are not bound by any obligations towards sustainable development, apart, of course, from those obligations which are imposed by law to all market participants (e.g. environmental law).

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4. Pursuing Sustainable Development in Privatized Enterprises Through Golden Shares and CSR

4.1. Sustainable Development through Golden Shares in Privatized Companies

Many States were willing to proceed to privatizations of their State-owned companies. Nevertheless, they wanted to retain certain control over these privatized companies, where they had transferred corporate control to private investors. This intention of the State to continue to control privatized companies was stronger, when the privatized companies were active in strategic areas of the national economy (e.g. energy, telecommunications, infrastructures, etc.). One way of securing control over these privatized companies was through golden shares or special shares. Golden shares or special shares (hereinafter “golden shares”) could be defined as certain prerogatives that States retain in privatized companies, which do not correspond to their shareholding. These prerogatives entail veto rights over certain decisions of the board, of the directors and of the general meeting, power to appoint a certain number of board members, voting caps, restrictions on the acquisition of shares, etc. It is easily understood that the State is interested in benefiting from the private economy by selling its shares to private investors, while it retains control over these privatized companies by adopting a protectionist tool, such as golden shares.

Before their privatization, States might exercise their shareholders’ rights in these State-owned companies, according to sustainable development. Certain decisions of the State as shareholder in State-owned companies might take into consideration sustainability. The State as shareholder in State-owned companies could seek to achieve certain sustainable development goals, such as environmental protection, better working conditions for their employees, gender equality, consumer-friendly commercial practices, as well as low prices for goods and services, support to the local communities, setting up resilient infrastructure, etc. These sustainable development goals are often in harmony with the objectives of most of these State-owned companies, which are offering public services (transports, telecommunications, energy, etc.).

It is possible for a State to preserve a certain level of control over privatized companies in order to promote sustainable development. More specifically, States could use golden shares in order to promote sustainable development. These prerogatives, which the State continues to enjoy in privatized companies, could be exercised in favour of sustainable development goals. Even if the private investors controlling the privatized company are not interested in sustainability, the State as a shareholder could exercise its enhanced rights through golden shares in order to promote sustainability. For example, environmental protection, production and/or consumption of

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clean energy, donations and other methods of support to local communities, gender representation on the boards of directors of State-owned companies, etc.\textsuperscript{53} could constitute sustainable development goals, which could be promoted by the State through golden shares. Moreover, before the privatization, certain sustainability requirements could be introduced to the articles of association of the privatized company by the State. The State could add certain provisions to the articles of association, which would make the abolishment of these sustainability requirements more difficult (e.g. increased quorum and supermajority, time limits, etc.). However, the possibility of a State to retain golden shares in privatized companies is falling within the ambit of European Union Law and must comply with its requirements.

Many EU Member States, which proceeded to privatizations used golden shares in order to preserve a certain level of control after the privatization. The European Commission was suspicious towards these golden shares, which constituted a protectionist measure in the context of the internal market. The European Commission considered that these golden shares constituted infringements of EU fundamental freedoms, and more specifically, of freedom of establishment and of free movement of capital (Arts. 49 and 63 TFEU).\textsuperscript{54} The Court of Justice of the European Union (hereinafter “CJEU”) had the chance to examine the compatibility of many national schemes of golden shares with the EU fundamental freedoms. In a series of cases known as the golden shares case law\textsuperscript{55}, the CJEU scrutinized the compatibility of golden shares with internal market rules. In all these cases, the CJEU found that golden shares preserved by Member States in privatized companies constituted infringements of EU fundamental freedoms. Member States tried to justify these infringements on the basis of public interest considerations. These justifications were based on TFEU provisions (Arts. 52 (1) and 65 (1) TFEU), as well as on the mandatory requirements in the public interest deriving from case law.\textsuperscript{56}


\textsuperscript{56} For a critical overview of the golden shares case law of the CJEU, see: M Andenas and F Wooldridge, \textit{European Comparative Company Law}, 14-20 (Cambridge University Press 2009). For analysis of various aspects of golden shares case law, see: S Grundmann and F Möslin, \textit{Golden Shares – State Control in Privatised Companies: Comparative Law, European Law and Policy Aspects} 1 Euro-
Only in one case, the CJEU accepted the justification invoked by the Member State. In this case, the CJEU considered these prerogatives enjoyed by the Member State in a privatized company as a justified derogation to EU fundamental freedoms. This case was *Commission v. Belgium.* In all the other golden shares cases, the CJEU did not accept the justifications invoked by Member States. The Belgian system of golden shares entailed a right to oppose, ex post facto, some corporate decisions in privatized energy companies coupled with some very strong administrative law safeguards (right to oppose only specific corporate decisions, no arbitrary exercise of the rights of golden shares but fully-justified and available for judicial review). These elements were missing from the golden shares schemes of the other cases. Hence, the Belgian system of golden shares was considered to pursue the justifying ground of guaranteeing energy supply in the event of a crisis (public security considerations (Art. 65 TFEU)). As a result of the acceptance of this justification by the CJEU, Belgium managed to preserve its national system of golden shares.

The Cyprus government could retain certain golden shares in privatized companies. One goal of State control through golden shares should be sustainable development. The Cyprus government should examine carefully the possibility of introducing golden shares. In the Cyprus MoU, there are no provisions about the maintenance of a certain degree of influence or specific prerogatives in the privatized enterprises. The MoU requires privatizations of State-owned enterprises, but it remains silent about the introduction of golden shares. It neither prohibits nor allows golden shares. It could be deduced that Cyprus might retain a certain degree of influence in compliance with the case law of the CJEU on golden shares. As a result, the Cyprus government could preserve a degree of influence through golden shares over privatized companies. This influence could be exercised in favour of sustainable development. As it was mentioned above, the justifying grounds for these golden shares could be various goals of sustainable development, such as environmental protection and climate action, human rights protection, employment protection, protection of public health,
clean energy, reduced inequalities, gender equality, decent work and economic growth, attention to the local communities etc.58 These justifying grounds constitute lawful derogations to EU fundamental freedoms only if they comply with the golden shares case law of the CJEU and, more specifically, with the standards set by Commission v. Belgium. These justifying grounds are public interest59 considerations, which the State as a shareholder could pursue in State-owned companies. After privatization, when the corporate control would be transferred to private investors, the State could continue to pursue these public interest considerations underpinning sustainability through golden shares in privatized companies.

4.2. Corporate Social Responsibility in Privatized Enterprises: Bold Proposals

Apart from golden shares, Corporate Social Responsibility (hereinafter “CSR”) could play a very important role in privatized enterprises. A bold proposal could be the introduction of mandatory CSR obligations for privatized enterprises. Before the divestment of the shares to private investors, States could introduce certain CRS codes, which would be binding to State-owned enterprises under privatization.60 Hence, after the privatization, the privatized enterprise would pursue sustainable development by complying with these CSR codes. CSR codes could be binding only for privatized enterprises offering public services; this would correspond to their mission and their corporate objective. Nevertheless, this is a quite bold proposal, which is difficult to be realized. In the legal framework of privatizations in Cyprus, there is no such provision on CSR.

Although the National Action Plan for CSR of the Republic of Cyprus61 has no specific reference to privatizations, there are certain provisions for State-owned enterprises (the so called “semi-governmental organizations”). A responsible business conduct is usually expected from State-owned enterprises.62 Cyprus considered the

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59 For the notion of public interest in State-owned enterprises, see: A Iliadou, Public Enterprise, 80-87 (Athens, Nomiki Viviothiki, 2016) (in Greek).
60 This argument could be justified by OECD Guidelines on Corporate Governance of State-Owned Enterprises. According to these Guidelines: “The state exercises the ownership of SOEs in the interest of the general public. It should carefully evaluate and disclose the objectives that justify state ownership and subject these to a recurrent review.” OECD Guidelines on Corporate Governance of State-Owned Enterprises (2015), pp 17, 29.
62 According to the OECD Guidelines on Corporate Governance of State-Owned Enterprises: “The ultimate purpose of state ownership of enterprises should be to maximise value for society, through an efficient allocation of resources.”; “The state ownership policy should fully recognise SOEs’ responsibilities towards stakeholders and request that SOEs report on their relations with stakeholders. It should make clear any expectations the state has in respect of responsible business conduct by SOEs.” and “SOEs should observe high standards of responsible business conduct. Expectations established by the
2011 European Commission Communication on Corporate Social Responsibility\(^6\) and adopted the National Action Plan for CSR. The National Action Plan for CSR proposes that the State-owned enterprises must promote sustainability reporting by issuing a special report on Social Responsibility, which should include up to 20 indicators based on GRI Sustainability Reporting Standards.\(^64\) State-owned enterprises could choose the indicators, which are considered to be more relevant with their area of business, apart from specific crucial indicators, which would be chosen in consultation with all the State-owned enterprises and which would be common for all of them. State-owned enterprises should also promote CSR through their official websites.\(^65\) Additionally, the National Action Plan for CSR suggests the adoption by the Cyprus government of certain measures for the boost of CSR in the field of human rights protection. More specifically, the National Action Plan for CSR proposes cooperation with NGOs and other specialized CSR bodies for the composition and promotion of a code for the protection of human rights, which would be used as a guide by private, semi-governmental and public bodies.\(^66\) This code should constitute a soft law instrument. The National Action Plan for CSR also advances environmental protection. It promotes the issuance of brief annual environmental reports with point of reference the coverage of the relevant GRI Sustainability Reporting Standards by State-owned enterprises. It also supports Green Public Procurement (GPP)\(^67\) of State-owned enterprises.\(^68\)

Cyprus is also taking other measures in order to enhance CSR. These measures could also be applicable to State-owned enterprises under privatization. First, Cyprus implemented recently Directive 2014/95/EU amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups. Companies Law (Amendment) (No. 3) of 2017 transposed this Directive into Cyprus law by amending the Companies Law (Chapter 113) and entered into force on 2 June 2017. Secondly, the Cyprus Organization for Standardisation (CYS) issued the Cyprus standard CYS ISO 26000:2014 – Guidance on Social Responsibility. Thirdly, the Cyprus government incorporated CSR actions into the Policy Statement for Enhancing the Entrepreneurial Ecosystem in Cyprus for the government in this regard should be publicly disclosed and mechanisms for their implementation be clearly established.” OECD Guidelines on Corporate Governance of State-Owned Enterprises (2015), pp 17, 23, 29, 57, 60.


National Action Plan for CSR of the Republic of Cyprus, pp 33. For an evaluation of GRI, see: C Villiers and J Mahonen Accounting, Auditing, and Reporting: Supporting or Obstructing the Sustainable Companies Objective” in B Sjåfjell and BJ Richardson (eds), Company Law and Sustainability, Legal Barriers and Opportunities, 216-218 (Cambridge University Press 2015).

National Action Plan for CSR of the Republic of Cyprus, pp 44.

Ibid., pp 42.


National Action Plan for CSR of the Republic of Cyprus, pp 34.
period 2016-2020. This initiative stresses the high business value of CSR in Cyprus. Fourthly, there are many mechanisms supporting CSR, such as EMAS, EU Ecolabel, grant schemes for the use of RES, certifications of good business practices against gender discrimination, competitions for good practices as regards safety and health at work, codes of good practice, regarding disability discrimination in employment and occupation, regarding the prevention of sexual harassment and harassment in employment and regarding the combat of racism. These measures, which could already be used by State-owned enterprises in order to promote CSR, could also be used by privatized enterprises.

However, there is no link between all these CSR measures and the privatization framework of Cyprus described above. This omission endangers the applicability of these CSR measures to the privatized company considering that these are soft law instruments. Apart from Companies Law (Amendment) (No. 3) of 2017, which implements Directive 2014/95/EU, the rest are soft law instruments. References to some of these CSR measures could have been made in the Privatizations Law of Cyprus. Of course, privatized companies could apply voluntarily these CSR measures. However, the Privatizations Law could have provided a stronger boost towards this direction. Many of the State-owned companies already apply CSR measures, according to the provisions of the National Action Plan for CSR. These companies should continue to apply these CSR measures after their privatization. On the one hand, it would be too bold to argue for a mandatory imposition by the Privatizations Law of CSR standards on privatized companies. On the other hand, specific soft law provisions in the Privatizations Law encouraging the adoption of CSR measures by the privatized companies on the basis of a “comply or explain” principle would contribute to sustainable development. The new controlling shareholders in privatized companies should understand that they have assumed the previous role that the State was playing as shareholder. This role was closely related with public interest considerations, because the State as a shareholder took into account quite often public interest and was not always guided by the shareholder primacy.

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71 For an interesting approach to shareholder rights and responsibilities regarding shareholder’s activist conduct in the general meetings of systemic enterprises and shareholder responsibility as to voting without having an economic interest in the company in which the votes are casted (“empty voting”), see: R Houben and G Straetmans, Shareholder Rights and Responsibilities in the Context of Corporate Social Responsibility 27 European Business Law Review 615-637 (2016).

72 A Iliadou, Public Enterprises, 80-87 (Athens, Nomiki Viviothiki, 2016) (in Greek).

73 B Sjåfjell, A Johnston, L Anker-Sørensen, and D Millon, ‘Shareholder Primacy: The Main Barrier to Sustainable Companies’ in B Sjåfjell and BJ Richardson (eds), Company Law and Sustainability. Legal Barriers and Opportunities, 79-147 (Cambridge University Press 2015). Sometimes, it is dif-
of State-owned companies is not led by purely economic considerations, but wider socioeconomic elements should often be weighed.\textsuperscript{74} Of course, it could not be asked from the new shareholders of the privatized company to continue to fulfill exclusively these public interest considerations\textsuperscript{75}, but implementation of a CSR policy is deemed necessary.

As it was mentioned above, sell or lease of immovable property, which belongs to the State, as well as licensing of certain business activities (e.g. casinos/lotteries) fall within the scope of privatizations. These methods of privatization should also implement CSR measures (e.g. environmental protection for sell/lease of immovable property or advertisements warning for addiction to gambling in case of licensed casinos or lotteries).

5. Challenges for the Privatization Programme of Cyprus

The privatization programme of Cyprus faces certain challenges. A very important challenge lies within the framework of sustainable development. The contribution of this privatization procedure to sustainable development is questioned. The fact that the legal framework of privatizations does not have specific provisions for sustainability might be proved quite detrimental to sustainable development. While there are certain CSR initiatives, which are addressed to State-owned enterprises, it is uncertain whether the newly privatized enterprises would follow a CSR policy (at least as robust as the one of the State-owned enterprise). Before the privatization, there are certain CSR actions available for State-owned enterprises. After the privatization, there is the danger that these CSR initiatives might be fully or partly abandoned by the privatized enterprise. This lacuna of the privatization framework is quite crucial for the post-privatization CSR landscape. The legal framework of privatizations should have explicit provisions encouraging compliance with CSR standards after privatization. Nevertheless, references to CSR are missing. There is only a requirement for compliance with EU competition law. Art. 5 (f) of Privatizations Law demands the adoption of special legislation for monopolies, which would result from privatizations. This provision contributes significantly to consumer protection and to an undistorted competition, after the completion of the privatization.

\textsuperscript{74} A Biondi, \textit{When the State is the Owner—Some Further Comments on the Court of Justice ‘Golden Shares’ Strategy} in U Bernitz and W-G Ringe (eds), \textit{Company Law and Economic Protectionism}, 102 (Oxford University Press, 2010).

\textsuperscript{75} See, the case of public utilities: enterprises(companies) which are owned by local governments and charged with the provision of services of general interest (SGI). C Herzberg, \textit{Extending the Stakeholder Approach to the Community: Mechanisms for Participative Modernisation in Public Utilities} in S Vitals and J Heusschmid (eds), \textit{European Company Law and the Sustainable Company: A Stakeholder Approach, Vol. II}, 223-252 (Brussels, European Trade Union Institute-ETUI, 2012).
There are some more challenges for the privatization programme of Cyprus. It remains to see how the legal framework of privatizations would be implemented in practice. Some privatizations already took place, while some others are still pending. Privatizations are a politically sensitive sector. The realization of the privatization programme depends on political decisions. As we noticed, the Council of Ministers and the House of Representatives play key roles in the privatization process. The Economic Adjustment Programme of Cyprus ended and Cyprus exited the financial crisis. A challenge for Cyprus is the fulfillment of the various pending MoU requirements in the post-crisis era. The key question is whether Cyprus is going to proceed to the rest of the privatizations. This is probably a political question. In the nearby future, it would be clear if there is the political willingness to proceed to the rest of the privatizations. After leaving the financial crisis behind, Cyprus could now borrow from international financial markets and proceeds from privatizations are not so important any more. Privatizations are related primarily with budgetary aims, but not only with them. Privatizations also concern the reorganization of the public sector and the new approach of Cyprus towards economy, by limiting its intervention into the market. Furthermore, many employee protection issues are arising from privatizations. Most of the State-owned enterprises have a surplus of personnel. The terms of employment would probably have to change after the privatization. Hence, the Privatizations Law requires consultation and exchange of information with the representatives of employees.76

These concerns expressed above about the future of the privatization programme of Cyprus were confirmed with the worst manner by a recent Law, which abrogated the Privatizations Law. The House of Representatives adopted a new Law abrogating the Privatizations Law.77 According to Art. 140 of the Constitution of Cyprus, the President of the Republic of Cyprus challenged and referred to the Supreme Court of Cyprus the legality of this new Law. The President of the Republic of Cyprus argued that this new Law abrogating the Privatizations Law was unconstitutional due to an infringement of the separation of powers and of various other provisions of the Constitution of Cyprus (Arts. 26, 54, 61, 80 and 179). The Supreme Court of Cyprus held that this new Law was lawful and did not infringe the separation of powers (6 Judges agreed with this view, while 5 Judges disagreed, adopted a dissenting opinion and argued in favour of the infringement).78 Hence, after this ruling, this new Law became fully effective and abrogated the Privatizations Law.

This abrogation of the procedural framework is the biggest challenge for the privatization programme of Cyprus. After the end of the Economic Adjustment Programme, Cyprus is subject to a post-programme surveillance until at least 75% of the

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financial assistance granted would be repaid. This mechanism evaluates the economic, fiscal and financial situation of Cyprus and examines whether corrective measures and further economic adjustments are necessary. The post-programme surveillance ensures that Cyprus could repay the loans received by the European Stability Mechanism (ESM). If Cyprus does not proceed to any early repayments of the loans received, the post-programme surveillance will be preserved at least until 2029.\textsuperscript{79} The post-programme surveillance of Cyprus focused, among others, on the problems and on the frustration of the privatization process. All Post-Programme Surveillance Reports (Autumn 2016, Spring 2017 and Autumn 2017) commented negatively on the delays and on the deficiencies of the privatization programme. The Autumn 2017 Post-Programme Surveillance Report referred to the adoption of the new Law abrogating the Privatizations Law, as well as to its pending review by the Supreme Court. However, the Autumn 2017 Post-Programme Surveillance Report did not have the chance to provide a full-scale evaluation of this abrogation, as the decision of the Supreme Court was still pending back then. This Report stated that: “… the House of Representatives adopted a law abrogating the legal framework for privatisation. This abrogation was referred by the President of the Republic to the Supreme Court as unconstitutional, and therefore remains inapplicable. Such an abrogation would send a negative signal to investors, as the existing privatisation law, which was adopted during the programme, provides for a transparent and predictable framework for privatisation, including by identifying the objectives that must be pursued by these transactions. Should this law be abolished, privatisation would occur on an ad-hoc basis, with fewer guarantees as to the proper management of the process.”\textsuperscript{80} The next Post-Programme Surveillance Report is expected to examine comprehensively the negative impact of the abrogation of the Privatizations Law and is probably going to propose certain solutions. Cyprus might be asked to adopt a new Privatizations Law. It is quite difficult for Cyprus to remain without a specific legal framework for privatizations in the post-programme surveillance era. The absence of a procedural framework for privatizations is against legal certainty and creates psychological obstacles to investors. The post-programme surveillance might quite soon urge Cyprus to adopt a new Privatizations Law. It is obvious that this absence will affect adversely the national economy and the competitiveness of Cyprus. As a matter of fact, a new Privatizations Law is a necessity. The fact that the post-programme surveillance will continue until 2029, which is a quite long period of time, supports the argument and increases the possibilities that Cyprus would be finally urged to adopt a new Privatizations Law. Cyprus might not be able to evade the MoU requirement to have (and to retain) a consolidated procedural framework for privatizations, as


proceeds from privatizations are going to facilitate and guarantee the repayment of
the loans to ESM. Nevertheless, the political dimension with reference to political
reactions and reluctance to privatizations should also be taken into consideration.

A new Privatizations Law would probably be quite similar to the abolished Privat-
izations Law; the new Law would follow to a significant extent the structure and
substance of the old one. The Cyprus legislature is not expected to adopt significant
differentiations from the previous Law. A Privatization Unit might not be established
again, because there were certain issues about its high operational cost. However, the
new Privatizations Law should consider carefully all the concerns expressed above.
Various problematic characteristics of the previous regime could be avoided. Certain
amendments should unquestionably be adopted on the basis of the previous experi-
ence and the above analysis in order to ameliorate the new Privatizations Law. The
new Privatizations Law could pursue more intensively sustainable development in
privatized enterprises through golden shares and CSR. Sustainable development could
constitute an important dimension of the new Law. The critique expressed above
could be taken into account by the Cyprus legislature, when it would structure the
new Privatizations Law. The findings and the arguments of this paper could affect
the substance of the new Law and could definitely lead to an improvement of the legal
framework of privatizations in Cyprus.

6. Concluding Remarks

Privatizations constitute something new for Cyprus. There is no prior experience in
this area. Cyprus adopted a quite detailed legal framework of privatizations. A criti-
cal evaluation of this legal framework is essential.81 There are also some very impor-
tant challenges to the legal framework of privatizations in Cyprus, which affect its
foundations. Possible amendments might be required after a careful consideration of
its implementation. Best practices from privatization programmes of other Member
States must be followed. Hence, Cyprus would avoid problematic situations, which
other Member States confronted in the past during the realization of their privatiza-
tion programmes. Privatizations are not only a hot topic for Cyprus. Many other
Member States are planning to proceed to privatizations. For example, the Economic
Adjustment Programmes of some overindebted Member States of the Eurozone (e.g.
Greece) require certain privatizations. Many Central and Eastern European Member
States are also planning certain privatizations.

The legal framework of privatizations in Cyprus does not address sustainable
development. The Cyprus legislature did not take advantage of the opportunity to add
a sustainability dimension into the Privatizations Law. Although the Privatizations
Law is quite detailed, it does not refer to sustainable development. The various bod-

81 For a discussion of constraints operating on privatization, see: VV Ramanadham, Privatization:
Constraints and Impacts in VV Ramanadham (ed.), Constraints and Impacts of Privatization, 1-24
ies involved, as well as the various stages of the privatization process are not encouraging sustainable development. Nevertheless, sustainable development could be pursued in privatized enterprises through golden shares and CSR.

First, sustainable development could be pursued through golden shares in privatized companies. These golden shares could be justified on the basis of public interest considerations. Sustainable development goals could be incorporated into these public interest considerations. However, the introduction of golden shares requires compatibility with EU law. Member States should consider carefully CJEU’s case law on golden shares, when they are structuring their golden shares. The findings of the CJEU in Commission v. Belgium on the acceptable justifying grounds for golden shares could be used as a guide for Member States planning to preserve or even to introduce for the first time golden shares in their privatized companies. This case law on justified restrictions deriving from golden shares of privatized enterprises is very important for sustainable development goals constituting parts of the justifying grounds of public interest considerations. Otherwise, it is possible the sustainable development goals of these privatization programmes not to be accepted as valid justifications and, as a result, the specific golden shares to be unlawful. Hence, it is possible for Cyprus to introduce golden shares in privatized companies in order to attain sustainable development objectives without prejudice to compliance with CJEU’s case law on golden shares.

Secondly, CSR is considered a very useful tool for the promotion of sustainability. As a matter of fact, certain proposals on CSR could be brought forward. A bold proposal could be the introduction of mandatory CSR obligations for privatized enterprises. However, this choice remains highly improbable. Although the National Action Plan for CSR of the Republic of Cyprus has no specific reference to privatizations, there are certain CSR provisions for State-owned enterprises. Cyprus is also taking other measures in order to enhance CSR. However, there is no link between all these CSR measures and the privatization framework of Cyprus, described above. This omission endangers the applicability of these CSR measures to the privatized enterprise taking into account that these are soft law instruments. The Privatizations Law should have included certain mechanisms encouraging the implementation of CSR policies by the privatized enterprises. CSR is essential in areas of the market, from where the State withdrew and private parties came into play, such as privatized enterprises.
Annex

Diagram-Institutional Framework of Privatisations in Cyprus

The chart below shows the proposed structure as regards privatizations.