

The Effect of EU Energy and Climate Policies on the Production Sectors of the Economy of Cyprus – Final Results

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Executive Summary

This report summarises work that was carried out in the frame of the research project entitled “Economic Impacts from the Implementation of the European Union’s Energy and Climate Change Legislation Package in Cyprus”, which is funded by the Research Promotion Foundation of Cyprus in the framework of ‘DESMI 2009-2010’, a programme co-funded by the Republic of Cyprus and the European Regional Development Fund (project number ΑΕΙΦΟΡΙΑ/ΚΟΙΑΦ/0609(BIE)/02).

The European Union’s energy and climate policy package, legally adopted in early 2009, will affect the European economy because it will induce an increase in energy prices. In this project we model the effect of this policy package on the economy of Cyprus, a small EU island state. We formulate and estimate econometrically a production model that embodies rational expectations and dynamic optimization, accounting not only for efficiency gains due to investments in energy-saving technology but also for adjustment costs associated with capital, energy and other input replacement. We then simulate changes in factor demand and production costs up to the year 2020. Production costs may grow modestly over the entire economy of Cyprus as a result of the effect of higher energy prices induced by EU policies. Our cost estimates are higher than those calculated by the European Commission when setting the targets of its energy and climate legislation.