

5th Economic Congress
The State and Prospects of the Cyprus Economy

“Redeveloping the Growth Model for Cyprus” –
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Ladies and Gentlemen,

Allow me first of all to thank the organizers for their kind invitation. It is a pleasure and an honor to join such an impressive list of speakers.

‘How to redevelop the Growth Model for Cyprus’.

That is the theme of the speech I was asked to deliver.

I would, on my behalf, make **one addition**. The question is how to redevelop the Growth Model for Cyprus in order to achieve **sustainable** growth.

Because this is the only kind of Growth that creates – through productive jobs and higher incomes - **lasting prosperity**.

As opposed to **bubble-led growth**, which creates public and private over-consumption, usually through private and public borrowing, and creates short-term but temporary and artificial increase of incomes and prosperity. It subsequently brings inevitable disaster to the economy and the society when the decades-old bubble bursts.

And this is partly what happened to Cyprus. After a couple of decades of being one of the most dynamic and fastest growing economies in Europe, by 2013, we were faced with an unprecedented crisis.

A **severe banking crisis**, created by reckless credit expansion led to a collapse of one of our systemic banks and a significant bail in of deposit of the second bank. It shook the whole economy and left it struggling with the heavy burden of NPLs.

An equally severe **fiscal crisis** created by reckless public and non-sustainable borrowing in '**good times**'. Which left the government with no access to the markets and with practically **no fiscal ammunition** to find the necessary remedies when the '**bad times**' came. Something, which contradicts the philosophy of even the biggest advocates of Keynes.

With unemployment increasing to unprecedented levels.

Ladies and gentlemen,

Two years passed since the “perfect storm”. Our newly-elected - at the time - government quickly came to an agreement with the Troika institutions on a conditions-based support programme.

A support programme that offered us valuable breathing space and enabled us to focus towards the implementation of a programme of economic reform and consolidation. Since then things have improved significantly. We have implemented an economic consolidation and reform program which is delivering.

A **difficult program** that allows us, two years later, to see our economic performance rebounding and international investors placing a vote of confidence to our country and bringing fresh money into the banking sector and our economy.

But have we finished the job?

The **answer is simple and it is negative**. I consider Cyprus to be an economy in **transition**. We still have a **long** way to go if we want to turn Cyprus into a modern competitive economy, able to produce more, able to sustain growth.

So what has to be done? How do we redesign the growth model of the Cypriot economy?

Well, the answer is simple and straight forward; We have to continue applying the rules of economic orthodoxy. **Economics, is the painful elaboration of the obvious.** And it is the obvious that most of the developed economies recognised and acted accordingly. The economies that succeeded in raising the level of income and the welfare of their people.

In my opinion, there are no magical solutions. Any effort to generate sustainable growth should always lay its foundations on **three main pillars;**

The **first pillar** has to do with **the banking sector**, I won't spend much time here. After all that happened we inevitably we have a smaller banking sector, but without the excesses of the recent past. Built on healthy grounds. Better capitalised, better managed, and better supervised. Its main challenge now is to handle the big burden of the NPLs which is perhaps the single most negative factor restricting our growth potential. It is not easy and it will take time. But at least the tools are now in hand.

The **second pillar** deals with the fiscal situation. Public expenditure and the excessive deficit did come down and was eventually eliminated in order to reduce the overall debt burden

from our economy. We did make significant progress but more has to be done.

We have to ensure that public finances and the payroll will **remain on a sustainable path**. That their rate of increase is **not immuned** from the economic realities and the performance of the overall economy. That they will **not keep crowding-out** other public expenditure and developmental policies in the future, as they did in the past. More importantly, we have to ensure that the financing needs of the public sector will remain in control as to avoid the need of any **future tax hikes**.

Because maintaining, not only a stable, but a competitive tax regime and **low taxes** is a **key element of success** for a sustainable growth model for an economy like Cyprus. It is a key element for creating an attractive business and investment environment which by itself is a *sine qua non* for growth.

Because **the most severe form of austerity are the continuous tax hikes** which erode the purchasing power of the consumer; which kill the business environment and drive investments away.

It is of course an '**easy solution**' for any government when faced with fiscal problems. But it is an **anti-growth** policy which we have succeeded to avoid during the time of deep crisis and it is

something that we are determined to avoid in the future. We actually want to create those exact conditions that will allow us to move to the opposite direction! We are still not there yet but this is the direction we are moving through the gradual implementation of the **Public Financial Management reform** and the civil service reform.

Nevertheless, **there is much more to be done.**

We do acknowledge that these two pillars, although necessary **are not sufficient** conditions for becoming competitive or for creating what we call a sustainable growth model.

They need to be complemented by a '**comprehensive national structural reform program**' which goes beyond the basic requirements of the support program.

They need to be complemented by **more strategic interventions in the economy** through administrative, regulatory and procedural reforms.

And **this is what I consider to be the third but extremely important pillar of economic reform.**

There can be no sustainable growth model without structural reform. Structural reforms such as:

- Strengthening the **governance for Growth** in key areas of the economy such as the Research and Innovation sector, shipping, tourism, or agriculture. A huge task that requires the creation of new structures - political and technocratic – and change of competences between government ministries, departments and semi-governmental organisations. Sound governance has a catalytic role in the design and implementation of pro-growth policies.
- Design new, comprehensive, medium term and long-term **National Strategies** in all of those key sectors of the economy which will include concrete actions and not just yearly subsidy programs.
- A **bold public administration reform** which will create a more efficient and more growth-friendly public service.
- **Deregulation** in over-regulated sectors of the economy such as land administration, tourism and urban planning.
- **Creating** the necessary institutional and regulatory environment for promising sectors of the economy which suffer from a lack of a modern institutional and legal framework. Sectors such as innovation and start-ups, Funds, and professional services.

- **Privatisations**, which should be seen as a reform that will boost competitiveness, attract foreign investment in key sectors of our economies, and bring fresh money into the economy.
- **Streamlining of procedures**, cutting back on red tape and changing the whole framework for the licensing of strategic investments, amongst others through a new investment law.
- A **local government reform** that will also re-address the role of the municipal authorities in promoting growth.
- An **education reform**, a more long-term investment to the most valuable asset of any country, our people, our human resources.
- **Liberalisation** in key sectors of the economy such as the electricity and the energy sector.
- A **judicial reform** with the establishment of an administrative court that will lead to a more effective enforcement of contracts.

These are not just headings. They are parts of a very detailed, comprehensive national reform program that will transform Cyprus and its economy.

For every reform there is an action-plan and a time-framework. There are expert studies being conducted; It is a huge project and an enormous effort is undertaken both at technocratic and at political level.

I don't think that since the establishment of the Republic there has been such a **multidimensional effort**. I would only compare this to the pre-accession period to the EU and the harmonization process, and that only in the legal context, with less technocratic and political challenges.

Any action in these areas **is politically difficult and demanding**, in any part of the world. It is even more politically difficult usually in Southern Europe and especially if put forward by a **minority government** like ours.

The reform effort requires a change in mentality and more rational thinking.

It takes time.

It requires **confrontation** with different interest groups, both in the public and the private sector. As the American economist Tomas Sowell said, *'The first lesson of economics is scarcity: There is never enough of anything to satisfy all those who want*

it. The first lesson of politics is to disregard the first lesson of economics'

Well we **try not to disregard this reality**. It is politically difficult and it requires bold political decisions but it is indeed necessary.

There is always reaction to change by the advocates of the status quo. By those who see their interests threatened by the change of affairs.

In some reform areas we proceed faster than in other areas. In some others we are behind our original planning. We face anticipated or many times unpredicted problems which cause delays or even sometimes compromise the substance. Legal, technocratic, political problems. We can not escape making mistakes.

We are fully aware that these politically difficult but necessary reforms will not bear fruits immediately, during our term in office, they have more long-term effects. But we must finish the job. We must openly acknowledge that this is where we must improve.

We should not shy away from the problems but remain committed to doing our best in resolving them. And it is those reforms which we will have to implement in our remaining time in office.

Ladies and gentlemen,

This combination of fiscal consolidation, a healthy financial sector, and the implementation of a **national structural reform program of our own ownership is instrumental**. It is instrumental when it comes to meeting a key policy objective, fundamental to any growth effort, of any country, of any government;

Confidence. And as we all know the economy is about confidence.

It was the **loss of confidence in the banks** that led to deposit outflows and less credit to the economy. It was the gradual regaining of this confidence that allowed banks to be fully recapitalized, pass the stress test, and for Cyprus to abolish all capital controls early. But at the end of the day it is this confidence that allows an investor safely invest in any country.

It was the **loss of confidence in the state**, which led to our exclusion from the markets and subsequently into a support program. It is the fiscal consolidation program which led to successive rating upgrades, an impressive improvement of our bond yields and will give the final signal to the markets to start lending us again cheaply.

It was a loss of confidence from the **consumers**, that brought down spending and lay-offs and it is the gradual regaining of their trust that will allow jobs to be created and incomes to rise.

A loss of confidence from investors means that they invest somewhere else. We live in a competitive world. And coming to the 'theme' of this panel, a sustainable growth model is at the end of the day where the investors chose to go.

And they will go somewhere where they will find a stable and attractive tax regime, a healthy financial sector, but also an open economy with a high degree of economic freedom. With a transparent, business and investment friendly environment that does not suffer from bureaucratic distortions. They seek an ecosystem where the private sector can create. And that's where they will create jobs and higher incomes.

Ladies and gentlemen,

I chose **not to** integrate in my intervention the prospects created by the existence of hydrocarbons in our Exclusive Economic Zone. We all know that the prospects are there and they are significant.

Nevertheless, I believe that **we owe it to our country** to design a sustainable Growth model **despite** those prospects. Because Cyprus has many comparative advantages and a big unutilized potential in many economic sectors

We ought to free this potential by implementing the right reforms and we should by no means see the energy prospects with an opportunistic eye **or as an excuse** to avoid the undergoing through the difficulty of implementing those reforms.

Nevertheless, let me conclude, by adding another, very significant pillar of Growth and prosperity. The solution of the Cyprus problem. A solution that will reunite the island, its people, the economy, and will establish good relations with Turkey.

Peace, regional stability, and **open markets not obstructed by political barriers are the Key factors conducive to economic development, business and investment.** Free and voluntary trade between people and neighbours, not handicapped by political problems are conducting factors to prosperity in a sustainable manner. This is how the EU achieved half a century of peace and prosperity for its people despite the recent economic problems. This is the example we have to follow in this part of the world.

Achieving peace, stability and regional cooperation, by reaching an agreement on a carefully designed Federation will definitely act as a catalyst for the economic development for Cyprus for the decades to come.

With huge potential benefits for many sectors of the economy; commerce, energy, tourism, shipping or transport. It will allow Cyprus to fully utilize its unique geographical location in all sectors of the economy. And this is where our political efforts should aim. **The solution of the Cyprus problem will be the most significant growth reform that we can hope for.**

Ladies and gentlemen,

Let me repeating once again my main message. There are no magical solutions to generate growth. **The answer is found in the obvious.** In taking advantage of the country's comparative advantages, in a healthy banking sector, sound public finances, and bold structural reforms, in peace and stability. It works.

And this is the job we have to do. By correcting, reforming, and consolidating our economy we lay the foundations for a more viable growth model for our country, relieved from the 'sins of our past'. **We should not fear the change.**

Because Cyprus is indeed an excellent place. To live, to do business, to invest, to prosper. As long as we allow it to utilize its full potential.

Thank you very much.