

# CYPRUS IN SEARCH OF A NEW ECONOMIC PARADIGM

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# INTRODUCTION

- To assess the current state of the Cyprus economy
- To briefly review causes of the crisis and to evaluate to what extent the crisis has been effectively dealt with to examine the current challenges that must be addressed
- To outline some major guidelines for a new economic vision and paradigm

# I. BACKGROUND AND CONTEXT

## Political and historical context

- From the 1974 disaster to recovery and the economic miracle
- Financial Globalization, the Collapse of the Socialist block and how Cyprus benefited
- Accession to the EU on May 1, 2004 and the adoption of the Euro on January 1, 2008
- When Cyprus entered the Eurozone there was a fiscal surplus of 0,9% of the GDP, the public debt was 45,1% of the GDP, inflation 4,7% and unemployment 3,2%  
(Reference to the change of the way of the calculation of the GDP by the European Statistical Service in 2014 which influences this data as well)

# I. BACKGROUND AND CONTEXT

## Political and historical context

- There was also a huge banking sector: total banking sector assets were €128 billion or 688% of GDP at the end of the second quarter of 2010; 2012- total assets dropped to €105 billion or 540% of GDP
- Explosion at Mari military base (July 2011); the cost for the economy was about 15% of GDP
- Furthermore, there was no adequate understanding of the architecture of the Eurozone and its implications

# I. BACKGROUND AND CONTEXT

## The economic crisis and the Troika

- The endogenous causes of the crisis:
  - Huge banking sector and imprudent practices, including reckless lending and lack of effective controls
  - Foreign, mostly Russian deposits, constituted a relatively high proportion of the total amount
  - Sustained budget deficits after 2008 and the increase of the public debt from 45,1% in 2008 to 79,7% of the GDP by the end of 2012

# I. BACKGROUND AND CONTEXT

## The economic crisis and the Troika

- The endogenous causes of the crisis:
  - Lack of adequate leadership at various levels of public life
  - Complacency and a misleading perception of invincibility
  - Both the state and the society spent beyond their means

# I. BACKGROUND AND CONTEXT

## The economic crisis and the Troika

- The exogenous causes of the crisis:
  - The international and European financial crisis
  - The negative European and International narrative around Cyprus's banking sector; there were serious problems, but at the same time deliberate exaggerations
  - The exposure to Greece; the haircut of the Greek debt in October 2011 and the loss of about €4,5 billion- about 25% of Cyprus GDP
  - The faulty architecture of the Eurozone

# I. BACKGROUND AND CONTEXT

## The socioeconomic cost of the Memorandum of Understanding

- The effects of EU-IMF-imposed bail-in program remain highly controversial
- Bail- in/ haircut of deposits- loss of massive wealth of €9,1 billion
- Massive loss for shareholders of the Laiki Popular Bank, which was closed down/resolved and for the Bank of Cyprus, which was restructured
- The Banking System of Cyprus suffered a huge loss and ownership changed hands

# I. BACKGROUND AND CONTEXT

## The socioeconomic cost of the Memorandum of Understanding

- Real GDP was reduced by 3,1% in 2012, 5,9% in 2013 and 1,4% in 2014
- Cyprus GDP shrank from €16,3 billion in 2012 to €15,1 billion in 2014 (at constant prices)
- In November 2014 the statistical Service of the European Commission changed the way of estimating the GDP for all EU countries. This was done in a way in which numbers looked/ appeared better
- The Public debt of Cyprus was 107,5% of the GDP in 2014; without the change in the way the GDP was calculated, the public debt would have been more than 120%

# I. BACKGROUND AND CONTEXT

## The socioeconomic cost of the Memorandum of Understanding

- High unemployment and underemployment
- Demographic outflow
- Increased inequality and high uncertainty
- Cyprus became a different country

# I. BACKGROUND AND CONTEXT

## Stabilization and Recovery

- The economy showed positive growth for the first time in 2015 with further acceleration: 2% (2015), 3,4% (2016), 3,9% (2017)
- It is important though to note that stabilization and recovery took place at a much lower level of GDP in comparison to the beginning of the crisis
- Unemployment gradually decreased: 17% in 2014, 15% in 2015, 12,6% in 2016 and 11% in 2017 not only as an outcome of the creation of new jobs; many Cypriots and others left the country while more and more Cypriots who study abroad do not return
- However, Public Debt was not significantly reduced and remained over 107% of GDP in 2017

## II. THE CYPRUS ECONOMY TODAY

### The rhetoric versus the results

- “Success story”; certainly it was/is an exaggeration. In actual fact there was stabilization at a low level of economic activity.
- The counter argument to the success story has been: “success story only when compared with Greece”
- Success story or else: the reality of the matter is that to the present day Cyprus lacks vision for the future, despite the fact that the country needs a new economic paradigm following the economic collapse of 2013

## II. THE CYPRUS ECONOMY TODAY

### An overview of developments: a sectoral approach

- The Banking sector still faces severe challenges; the non-performing loans constitute perhaps the greatest challenge to the economy
- With the economic collapse in 2013 the Laiki Bank was resolved, the Bank of Cyprus was restructured and the entire Banking system was recapitalized
- In 2018 the Cooperative Central Bank will undergo major restructuring and will cease to exist; the “good” part will be sold and the “bad” part will be taken over by a State Agency- the objective is to deal with the NPL'S

## II. THE CYPRUS ECONOMY TODAY

### An overview of developments: a sectoral approach

- The Non- Performing Loans which were €21,14 billion or 110% of GDP in 2017, constitute perhaps the most pressing problem of the banking system and the economy today
- It is interesting to note that the NPL'S were about 44% of the total in 2017 (about 49% in 2013); still remains the second highest in the EU
- In order to effectively address the thorny problem, in addition to sustained growth "thinking outside the box" is required. This may include various schemes of long-run leasing

## II. THE CYPRUS ECONOMY TODAY

### An overview of developments: a sectoral approach

- Tourism has been a strong pillar of growth and recovery
- The accommodation and food service activities sector kept growing despite the crisis
- Following the economic collapse in 2013, the property market as well as construction suffered a serious blow; by 2016 a gradual recovery of the sector began
- There have been great expectations from the energy sector given the discovery of huge amounts of hydrocarbons in Cyprus' Exclusive Economic Zone; nevertheless, exploitation seems very difficult without an understanding with Turkey
- Cyprus should seek alternative energy sources, including solar energy

## II. THE CYPRUS ECONOMY TODAY

### An overview of developments: a sectoral approach

- Shipping has been a promising sector; in the last few years its contribution to GDP has gradually increased
- It is essential to assess some stylized facts in relation to the labour market, unemployment, demographics, income distribution and inequality
- In sum: due to demographic outflows the labour supply was adversely affected; with the recovery unemployment dropped from over 20% to about 11%; nevertheless, figures improved as many Cypriots and others left the country. At the same time income inequality grew

## II. THE CYPRUS ECONOMY TODAY

### Fundamental Structural problems still existing

- Non- performing loans and the banking system
- Need to further rationalize public spending
- Need to push aside the patron- client relations and to promote meritocracy
- Lack of public sector reforms and growing inefficiency is reflected in Cyprus' falling standing in international rankings:
  - Competitiveness rank: # 83 (2017) vs # 34 (2010)
  - Corruption perception rank: # 42 (2017) vs # 27 (2009)
  - Ease of Doing Business: # 53 (2017) vs # 36 (2008)

## II. THE CYPRUS ECONOMY TODAY

### Fundamental Structural problems still existing

- Implement effectively the National Health System
- Improve the quality of education at all levels and increase the amount of resources allocated for research and development
- The public debt at the end of 2016 was 106,58% of GDP; private debt was at 342,77% of GDP. These must be addressed decisively and effectively

## II. THE CYPRUS ECONOMY TODAY

### The occupied northern part of Cyprus

- The population in the occupied part of Cyprus, excluding the 40.000 occupation troops, is about 300.000; 180.000 (60%) are settlers and 120.000 (40%) Turkish Cypriots
- Before the partial lifting of obstacles to the free movement in April 2003 the ratio of the per capita GDP in relation to the government controlled areas was estimated at 1:4. Currently it is estimated to be 1:2
- Essentially the self proclaimed "TRNC" is de facto part of Turkey's economic zone. The use of the Turkish Lira as the "official" currency since the summer of 1974 is indicative

## II. THE CYPRUS ECONOMY TODAY

### The occupied northern part of Cyprus

- It is estimated that Turkey subsidizes by about 25% the annual budget of the "TRNC"; this amount is estimated to be about €350 million annually
- Turkey also subsidizes infrastructural projects
- There are no effective controls in the banking system. The occupation authorities have denied access to EU and IMF officials for some fundamental assessment of the banking sector
- Turkish Cypriots used to prefer Cyprus national currency and since 2008 the Euro, despite the occupation conditions/regime

## II. THE CYPRUS ECONOMY TODAY

### The occupied northern part of Cyprus

- The economy of the “TRNC” is much more statist than the one in the government- controlled area
- Two other important sectors are tourism and higher education
- There is no “tax culture” in the “TRNC”
- High proportion of shadow economy, including gambling and money laundering
- In the last few years there are more and more mosques/Islamization in the “TRNC”
- There is no doubt that the “TRNC” has been created in Turkey’s image

# III. CHALLENGES AND OPPORTUNITIES

## Cyprus in the broader context

- Developments in the Eurozone and the repercussions
- Developments in the broader region and the international environment
- Cyprus and Brexit
- Cyprus and the risk of cascading crises
- Cyprus and Turkey

# III. CHALLENGES AND OPPORTUNITIES

## How to address the problem of the financial sector and of the non- performing loans

- Following 2013 the ownership of the banking system changed dramatically
- With the expected restructuring of the Cooperative Central Bank, there will be no banks in the hands of Greek Cypriots
- New ideas and thinking “outside the box” will be required to address the problem of the Non- Performing Loans
- From a situation of no controls and checks before 2013, to a new state of affairs with excessive controls

# III. CHALLENGES AND OPPORTUNITIES

## Addressing the challenge of the Financial Sector and of the Non- Performing Loans

- The most pressing problem of the financial- sector and perhaps of the economy as a whole are the Non- Performing Loans

	General government NPL'S € thousands		Corporations NPL'S € thousands		Households NPL'S € thousands		Total NPL'S € thousands	
	Amount	% of GDP	Amount	% of GDP	Amount	% of GDP	Amount	% of GDP
2014	62,304	0,35	14,686,569	83,42	12,579,419	71,45	27,328,292	155,22
2015	47,907	0.27	13,933,116	78,53	12,688,051	71,51	26,669,074	150,32
2016	39,426	0,22	11,733,566	64,40	12,037,053	66,07	23,810,045	130,69
2017	35,679	0,19	9,925,096	51,66	11,179,671	58,19	21,140,446	110,03

# III. CHALLENGES AND OPPORTUNITIES

## Addressing the challenge of the Financial Sector and of the Non- Performing Loans

- It is essential to utilize some new ideas such as long-run leasing
- Encourage more borrowing and stimulate economic activity
- Strike a new balance between effective controls, monitoring vis a vis flexibility and discretion
- Assess creatively the fundamental problems of the financial sector and generate a road map for addressing them
- Reestablish the credibility of the financial sector

# III. CHALLENGES AND OPPORTUNITIES

## Cyprus and the new International environment

- The new technological revolution and implications/ challenges for Cyprus
- The socio- economic and political fallout of demographic changes and developments
- The changing paradigm internationally
- Regional geopolitics and the implications
- The threat from Turkey

# III. CHALLENGES AND OPPORTUNITIES

## Attracting Foreign Investment

- What has been the record so far
- What kind of investment is required
- Capabilities and prospects
- Need for new engines of growth
- Quality of foreign investment: purchase of real estate and acquisition of passports vs Investment which creates new jobs

# III. CHALLENGES AND OPPORTUNITIES

## The Socioeconomic and Political Implications of a Solution to the Cyprus Problem

- Although much attention has been given to the solution of Cyprus problem, not much attention has been given to the day after
- A solution within the framework of what is being discussed will create a new state of affairs with a very complex decision making process
- Repeatedly there have been statements and reports which have been suggesting that following a solution there will be an economic boom
- However the reality is that there will be diverse forces pushing toward opposing sides

# III. CHALLENGES AND OPPORTUNITIES

## The Socioeconomic and Political Implications of a Solution to the Cyprus Problem

- In any case it is doubtful whether a bizonal bicomunal federal state with three governments, three parliaments and a senate, as well as a complex public administration, can fulfill the very strict rules of the Eurozone
- It is also essential to understand that each scenario for the solution of the Cyprus problem entails a specific outcome
- It is misleading to assume that irrespective of the content of the solution of the Cyprus problem the outcome will be the same

# IV. TOWARD A NEW PARADIGM

## No new paradigm yet

- It is essential to examine the factors which led to the recovery
- Assess the cost of inadequate planning and the lack of a new comprehensive paradigm
- New vision required

## Rationalization of public expenses and populism

- A major problem that has not been addressed even after the economic crisis is the lack of rationalization of public expenses; for example, within this framework it is essential to revisit public spending on higher education
- The high socioeconomic cost of populism

## IV. TOWARD A NEW PARADIGM

### Importance of enhancing the effectiveness of (the) public administration

- It is essential to address the serious problems of bureaucracy, nepotism and corruption
- The importance of meritocracy; pushing aside the patron- client relationships as well as mediocrity

# IV. TOWARD A NEW PARADIGM

## Effective utilization of the human capital

- Reassessing the composition of the labour supply and adequate planning for its utilization
- Most young Cypriots have acquired higher education- yet, Cyprus has one of the highest youth unemployment rates in the EU
- Understanding the causes and the nature of structural unemployment in the EU and Cyprus

# IV. TOWARD A NEW PARADIGM

## The need for new engines of growth

- Recovery and growth in Cyprus has not been the outcome of the new engines of growth which can sustain growth and development over time
- The potential of Cyprus as a higher education and medical centre
- The role of Cyprus as a centre for humanitarian, relief and disaster management operations across the Middle East and North Africa

# V. CONCLUDING REMARKS

- Cyprus needs vision to create a new economic paradigm
- Cyprus has to address effectively the pressing challenges and also move forward and to take advantage of opportunities
- It has to take steps so that the structural problem of the NPL's is addressed gradually but effectively
- It is essential to fully reestablish the credibility of the banking system and the financial sector as a whole
- It is important that both the public and the private debt are reduced gradually but steadily

# V. CONCLUDING REMARKS

- New engines of growth are required so that the economy will generate multiple jobs in order to absorb the labour force
- Cyprus must reassess its expectations in relation to quick energy exploitation; there are serious political complications which may create additional delays and security risks
- Last but not least, Cypriot policymakers should seriously study the socioeconomic and political implications of a solution to the Cyprus problem. It is misleading to assume that:
  - a) more or less the impact is the same from any solution
  - b) that any solution will generate positive socioeconomic and political outcomes