

Small States Economic Development

Cyprus

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Small States Economic Development: Historical Background

Economic Development 1960-1974

In the early 1960's Cyprus was a low-income agrarian economy with high levels of poverty and unemployment.

It experienced significant migration flows mostly to the United Kingdom.

Regarding economic development, during the period 1960-1974 Cyprus made the first steps towards economic modernization with the development of light manufacturing industry, urbanization, social security system and the setting up of economic governance institutions such as the Planning Bureau.

In 1974 the Cyprus economy faced a huge dislocation with a substantial loss of economic resources and the displacement of a large part of the population.

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Economic Development– Historical Background

- Overview and the economic history of the country

Introduction: Cyprus 1960-1974

Cyprus declared independence from British colonial rule in 1960. The period 1960-1974 was characterized by political turbulence and ethnic conflict between the Greek Cypriot and Turkish Cypriot communities in Cyprus. In 1974 Cyprus was invaded by Turkey following a military coup organized by the Greek Junta.

Since 1974 Cyprus has been a divided island between the northern part, controlled by the Turkish Cypriot community and heavily supported by Turkey and the southern part controlled by the Greek Cypriot community (Republic of Cyprus, internationally recognized). This report will refer to issues of economic development in the Republic of Cyprus.

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- Cyprus Economic Development 1974- 2020

- Key Economic events

- 1974-1980 Economic reconstruction following the Turkish invasion
 - 1987 Customs Union with the European Union
 - 1990 Strategy to attract offshore companies (corporate tax 10%)
 - 2000 Financial liberalization – Stock market crash
 - 2003 Corporate tax reduced to 10% for all companies to continue the Policy of attracting foreign capital for tax purposes
 - 2004 Cyprus accession to the EU
 - 2008 Cyprus adopts the euro
 - 2013 Financial crisis – Cyprus seeks EU financial assistance- Economic Stabilization Programme by the Troika (IMF-EU-ECB)

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- Structure of the economy

Cyprus is a middle- income developing economy with a total population around 890,000.

Total gross national product at market prices in 2019 was 20.5 billion euro.

Total income per head of population in 2019, 24.3 thousand Euro which represents 76% of the EU average.

The Cyprus economy depends heavily on the services sector (80% contribution to total gross value added) with very small contributions to GDP from agriculture (2% share to GDP) and manufacturing industry (5.2% share to GDP).

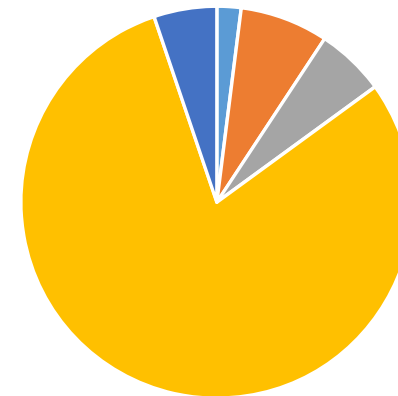
The balance of trade has been consistently in deficit which is covered to some extent by exports of services. In periods of economic growth the current account has been in deficit counterbalanced by capital inflows.

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- Structure of the economy

Contribution to Gross Value Added by branch of economic activity
(2018)

Sector	Percentage share in GVA
Agriculture	2
Industry (including energy)	7.3
Construction	5.7
Services	80
Manufacturing	5.2



■ Agriculture ■ Industry ■ Construction ■ Services ■ Manufacturing

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- The manufacturing sector in Cyprus
Comparison with other EU countries

EU member state	Manufacturing share	EU member state	Manufacturing share
Cyprus	5.4	Italy	16.7
Luxembourg	5.6	EU average	17
Malta	8.2	Finland	17.4
France	10.9	Austria	18.9
Greece	11	Slovakia	21.9
Latvia	11.8	Germany	22.6
Spain	12.4	Slovenia	23.3
Netherlands	12.4	Bulgaria	30.4
Belgium	13.7	Ireland	34.6
Portugal	13.8		
Estonia	14.9		

Why manufacturing matters?

- Productivity growth
- Technical advance
- Contribution to balance of payments
- High quality jobs
- Less dependence on exogenous factors
(tourism)



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- Structural imbalances

- A long -term perspective

The Cyprus economy has experienced continuous growth since 1974 as well as low levels of unemployment. The initial economic reconstruction following the 1974 Turkish invasion has been called the 'Cyprus Miracle' and the process of economic development for the whole period, until the 2013 financial crisis has been characterized as the 'Golden Age' of the Cyprus economy.

However, underneath these phenomena structural imbalances were developing, at different stages of the development process, leading to an unsustainable economic framework and eventually to the deep financial crisis of 2013.

- De-industrialization
- Balance of payments constraint
- The inflow of capital was associated with money-laundering and 'Tax planning'

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- Low levels of research and development, investment and productivity growth
- High level of dependence on the tourist sector
- Adverse environmental impact of the model of economic development
- High levels of income and wealth inequality and under-development of the welfare state.

The deep financial crisis of 2013 was the outcome of the imbalances of the Cyprus economy as much as the consequence of the Global and European financial crisis.

The policies pursued after the crisis did not address these issues but followed the framework imposed by the Troika which was broadly in line to the policies that had to be adopted in other countries of the European southern periphery that had to apply for financial assistance to the EU.

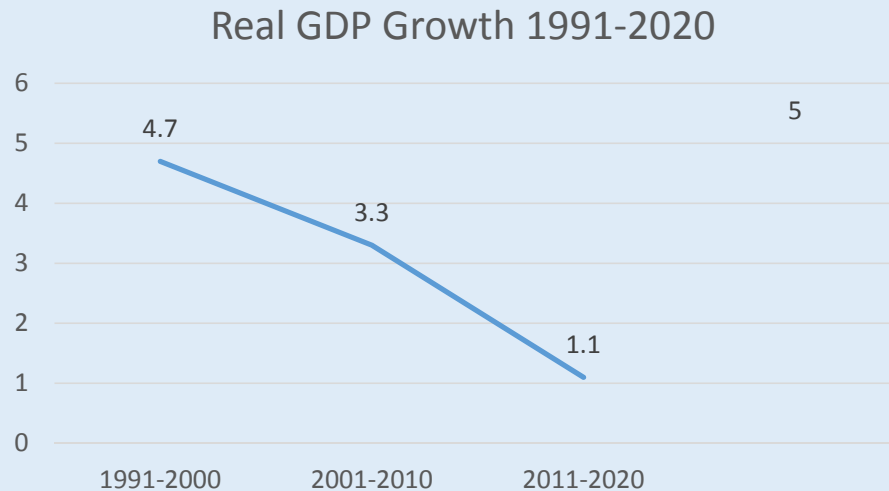
The need for an **alternative economic strategy and a new model of economic development** remains to this date and has become imperative in the context of the current global health crisis.

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Economic Development– Country overview

Economic Growth

- Cyprus had continuous GDP growth and low unemployment since 1974, until the deep financial crisis in 2013.
- Average GDP growth had been steadily falling during recent decades reflecting the structural imbalances of the economy.



Year	Real GDP growth
1991-2000	4.7
2001-2010	3.3
2011-2020	1.1

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- Recent economic Performance

Real GDP growth 2010-2019

- During the financial crisis 2012-2014 Cyprus had a cumulative fall in real GDP 10%.
 - Economic growth during the period 2015-2019 has been based on (i) increase in tourist arrivals (ii) increase in construction as a result of the 'golden visas' investment programme.
- Both sources of growth are not sustainable in the long-run.

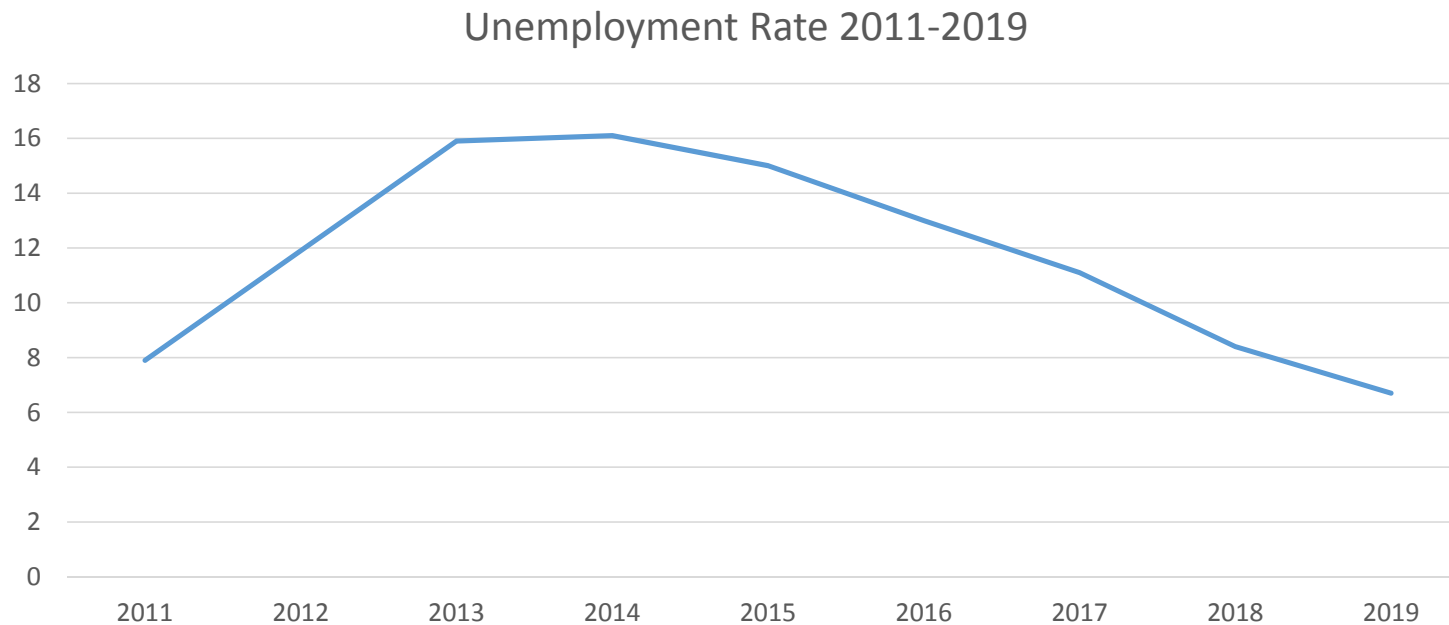


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- Recent Economic Performance

Unemployment Rate

- The average unemployment rate for 1991-2000 was 4.5%
- The rate of unemployment increased dramatically following the financial crisis to 16.1% but has been falling during the last 5 years 2014-2019.



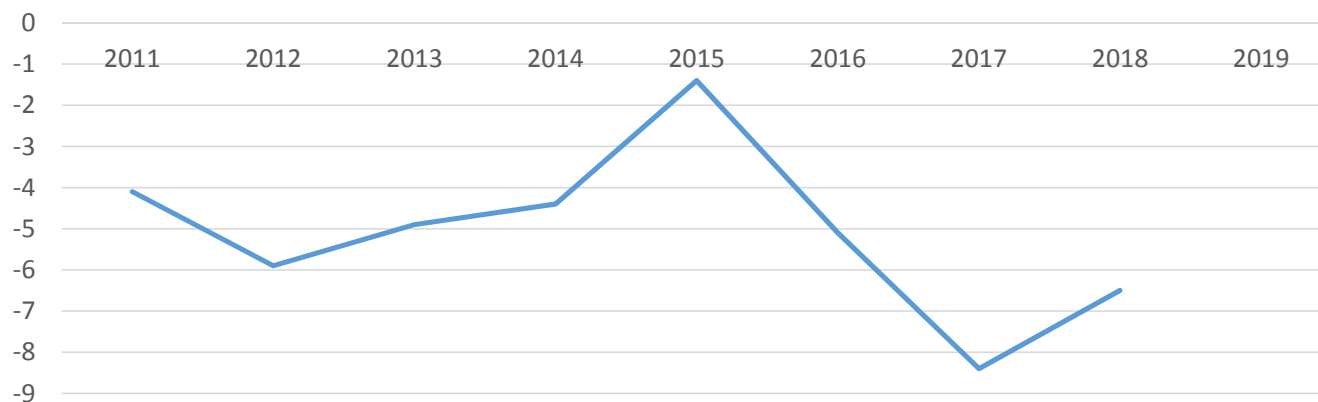
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- Recent Economic Performance

Balance of Payments Constraint

- The Cyprus economy consistently had a deficit balance of trade position, reflecting the weak productive base of the economy
- The balance of trade deficit was only partially covered by exports of services.
- The Cyprus economy faces a balance of payments constraint: periods of economic growth lead to unsustainable current account deficits.

Current Account Deficit 2011-2019



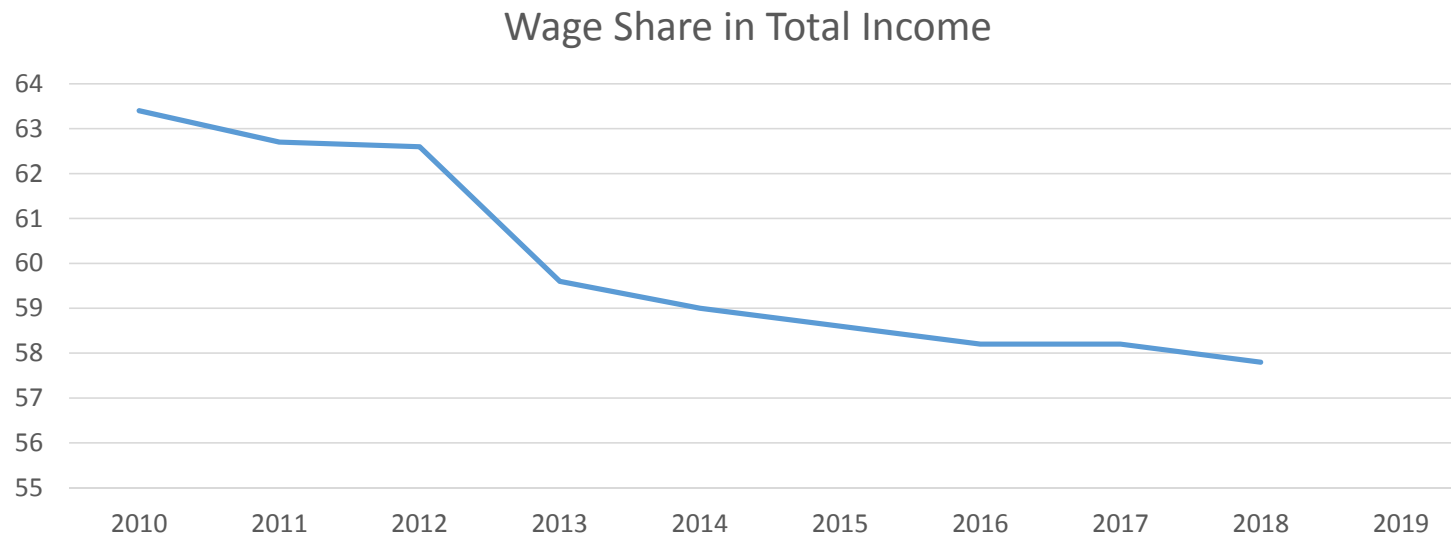
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Recent Economic Performance

Income Inequality: Reduction of the wage share

Following the Financial Crisis in Cyprus real wage growth was reduced.

The wage share in the economy was reduced substantially.



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Economic Development– Country Comparison

Well being Indices.

European and international comparisons

- **GDP per head of population.**

Common purchasing parity system (PPS)

EU15=100, Cyprus 81.1 (2019)

Cyprus has 18th position in EU27 rankings.

- **Human Development Index (HDI)**

HDI includes life expectancy, expected years of schooling, mean years of schooling and GNI per capita.

Cyprus is ranked 31st internationally.

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- Sustainable Development Goals (SDG)

Poverty

People at risk of poverty and social exclusion (2018)

Cyprus: 24%

EU average: 21.8%

Health

Life expectancy at birth

Cyprus- Females:85 – Males:81

EU average –Females:83 – Males:78

SUSTAINABLE DEVELOPMENT GOALS



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- Sustainable Development Goals (SDG)

Education

Tertiary education attendance

EU27 average: 40.1%

Cyprus: 58.2%

Climate Action

Greenhouse gas emissions

Index 1990: 100

2017 EU average: 80 Cyprus: 155

Share of renewable energy in gross final energy consumption

2018 EU average: 18.8% Cyprus: 13.8%

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Economic Development: Challenges ahead

Economic diversification of the economy

Expanding and upgrading the primary sector (agriculture) and secondary sector (manufacturing)

Balance of Payments constraint

Improve the export performance of the economy in terms of goods and services

Reform of the Banking sector

High level of non-performing loans over 40%

High private (300%) and public (100%) debt.

Sustainable Development – Green Growth

Reduce greenhouse gas emissions

Large-scale introduction of renewable sources of energy

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Extension and Upgrading the Welfare State System

A General Health System has been set up in 2019 and is expected to be completed in 2020

Income and wealth inequalities

Social Integration of Migrant Workers

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Mission Oriented Approach

Grand challenges of the Cyprus Economy and Society

- Economic restructuring -diversification

Agrarian and Industrial Strategy

Set up a Developmental Bank

State reform: Developmental State

Reform of the taxation system

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Grand Challenges – Policy Recommendations

Expansion and upgrading the welfare state system

Support and develop the General Health System

Housing Policy

Reform the education system

Introduce best practices: Nordic model

Sustainable Development – Green New Deal

Renewable forms of energy

Transport system

Sustainable Cities

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Economic Development: Current Strategies and Policies

Current strategies and Policies

- Fiscal austerity (primary budget surplus)
- Low taxes
- Lack of regulation and public control of the banking system
- Policies to attract foreign capital (low corporate taxes)
- Citizenship investment programme ('golden visas')
- Reform of the public sector according to the World Bank Governance Model

Small States Economic Development: Forecast

Conclusion

- At the current conjuncture (Coronavirus global health crisis) it is impossible to make any forecasts
- The Cyprus economy will go through a second crisis in a few years due to the high dependence on the tourist sector, fragile banking system and structural imbalances of the economy.
- There is a need for a new model of economic development in Cyprus.
- The political process for a settlement between the two ethnic communities in Cyprus must be renewed and come to fruition for the re-unification of the island.