

Economic Policies in Search of Growth

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Thank you for inviting me to this engaging debate. It is a real pleasure to be here today and I appreciate the opportunity to say a few words about the economy of Cyprus and the role of economic policies going forward.

Let me start on a positive note. Cyprus's economic reform program is producing real results. After going through an unprecedented downturn, the economy is stabilizing and we are starting to see encouraging signs, with the number of jobs now rising again. Economic activity has entered a path of gradual recovery, moving from an annual GDP growth rate of -5.4 percent in 2013 to -2.3 percent last year. Notably, these outcomes have exceeded our earlier expectations and those of other forecasters. In our recent World Economic Outlook, we forecast marginally positive growth for Cyprus in 2015, a rate of 0.2 percent, followed by a further gradual expansion in the following years.

The people of Cyprus should be given full credit for these results. It is only their determination in addressing economic and financial difficulties and for taking full ownership of far-reaching reforms that has allowed this progress.

It would not be a fair assessment, however, if we did not acknowledge the challenges still lying ahead and if we did not stress the need for even greater efforts going forward. In the search for growth two key priorities stand out: i) banks should be in a position to extend new credit to the economy, which, in turn, would let firms invest and create jobs more vigorously; and ii) the economy should manage to attract more capital through foreign direct investment. This again would boost economic growth and employment.

Targeted economic policies can support these priorities: growth in the economy and in jobs.

First and foremost, Cyprus must deal with its NPL problem. Why is this so important? NPLs approaching 60 percent of all loans are preventing banks from extending new credit to the economy. Understandably, financial institutions are not in a position to offer new lending if they are unlikely to get paid back. Only by lowering NPLs, we will allow banks to extend new credit and on better terms. This, as said, will support growth and jobs. The recently adopted legislation on foreclosure should provide creditors with a credible threat against strategic defaulters – borrowers, who can pay, but decide not to – and help restore a solid payment culture in the country. The foreclosure law has been complemented by a reform of the personal and corporate insolvency framework, which should allow debtors to either

restructure their loans or, for those who truly cannot pay, to have a “fresh start”. The combination of these two sets of measures should encourage banks and borrowers to move towards speedier solutions, which, in turn, should free up capital for new lending and support growth.

Another key policy priority is privatization. Progress on this front is also underway, after some delays, mainly of procedural nature, relative to the initial program. The privatization of state-owned enterprises is often portrayed as a way to raise short-term revenue for the state budget, while the long-run benefits to the economy are not given sufficient emphasis. On the contrary, these benefits are critical and include i) allowing for better and more cost-effective services for the population and (ii) attracting foreign direct investment, which again can bring jobs and increase liquidity in the economy. Therefore, going forward, it is important that further decisive steps are taken in this reform area too.

Finally, Cyprus should double its efforts to make the country a good place to do business. The government’s plan to put in place a growth strategy is a welcome initiative. Efforts should be addressed towards those areas where the gap relative to international best practices is the widest and the impact of reforms on long-run potential growth the highest. These include strengthening the legal system, opening up closed professions, removing barriers to competition, reducing red tape, and fostering innovation. These are all steps that could support growth, competitiveness, and innovation, and act as catalyst for further investment, thus helping to ensure a job-rich recovery.

Let me conclude by saying that there is no quick fix to the economic crisis the country went through over the past few years. Only steady and resolute implementation of structural reforms along the path already started can ensure a sustained return to economic prosperity and jobs. Most likely Cyprus will not go back to pre-crisis growth rates, and maybe it shouldn’t! That growth was rooted in major imbalances and proved unsustainable. But targeted reforms can ensure a return to jobs, stability and prosperity.