

CYPRUS ECONOMY: TIME FOR A PARADIGM SHIFT*

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When the Cyprus economy began to experience serious economic difficulties in 2008 the government was quick to suggest that these were the outcome of the international economic crisis. Furthermore, as stated confidently by President Christofias himself, the economy was strong and would more or less go through the crisis with little problems. The Ministry of Finance made growth projections which a simple search on the internet would bring embarrassment today. The reality turned out to be very different; irrespective of the international economic crisis the Cypriot economy has had and continues to have serious structural problems which even in the absence of regional and/or international shocks were bound to lead to high unemployment and soaring prices. Indeed, for some time now Cyprus has been facing the spectrum of "stagflation".

For years there has been an unacceptable level of complacency due to the successful record of what we have come to describe as the economic miracle. This in its turn contributed to a systematic violation of basic norms of rational economic management. For example, how is it possible not to have problems with pension funds when there are contributions and benefits of two speeds and which are indirectly related? Specifically, the pensions of employees of the civil service and of the broader public sector are proportionately higher, despite the fact that contributions from their salaries are lower than the respective deductions of employees in the private sector. This cannot continue. The perpetuation of such practices would be catastrophic.

Furthermore, for years there has been a misguided assumption, essentially in the broad public sector, that wages and benefits arose basically from collective agreements. It has been forgotten that ultimately it is the effectiveness of the economy that constitutes the main criterion for the terms of employment and prosperity. Consequently, during the recession of the period 2008-2010 the public payroll increased annually on average by about 8%. This was the

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outcome of automatic increments and cost of living allowances (COLA) as well as new personnel that was hired. Inevitably the fiscal indicators deteriorated. Similar actions in the semi-public institutions contributed to the increase of prices of utilities and other services.

While public expenditures on salaries grew recklessly the government wanted to find ways to increase its revenues, partly to pay the increments in the civil service. The government and the political system as a whole did not have the political courage to admit, let alone stress, that what is happening in Cyprus has no precedent. In other words it fails to understand that before trying to increase taxes further it is essential to also rationalize public spending. So far this has proved to be very difficult. This has to do with the fear of political cost in the event of taking action on the basis of economic rationale. Obviously, most politicians fear the strong unions of employees of the broad public sector.

It is also essential to acknowledge that the Cypriot labour structure has changed in the last 25 years. While in the 1980 only about 30% of young Cypriots received college and/or university education this has more than doubled; today almost two out of three Cypriots receive college and/or university education at different levels. Obviously, their expectations are different than those of their parents.

If the economic structure does not change, inevitably there will be higher unemployment. At the same time many young Cypriots will either not return to Cyprus after they complete their studies or if they do they will be forced to leave seeking opportunities elsewhere. Indeed the time has come for a paradigm shift. Cyprus needs new engines of growth and a rational approach to public spending and taxes. To a great extent the deep crisis of the Greek economy has been caused by the supremacy of politics over economic rationale. It is of utmost importance that Cyprus avoids this fatal path.