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CYPRUS

Recent Economic Developments

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Approved by the European Department

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Cyprus--Basic Data

Area (whole island)	9,251 square kilometers
Population (1980)	510,800 (whole island 628,500)
GNP per quota (1980)	£C 1,518 or SDR 3,305

<u>Output by sector in 1980</u> <u>at current prices</u>	<u>In millions</u> <u>of £C</u>	<u>In per</u> <u>cent</u>
Primary sectors	84.4	12.1
Agriculture	74.3	10.7
Industry	235.0	33.8
Manufacturing	124.6	17.9
Construction	100.1	14.4
Services	375.9	54.1
GDP at factor cost	695.3	100.0

	<u>1980</u>		<u>1979 1980 1981 1/</u>		
<u>National accounts</u>	<u>In millions of</u> <u>£C at current</u> <u>market prices</u>	<u>In per</u> <u>cent</u>	<u>Percentage changes</u> <u>at constant</u> <u>1979 prices</u>		
Private consumption	504.5	67.3	6.4	4.4	-0.1
Public consumption	107.6	14.3	9.1	5.0	4.7
Gross investment	270.0	36.0	8.2	-2.4	-2.8
Gross domestic expenditure	882.1	117.6	7.2	2.3	-0.4
Exports of goods and services	343.6	45.8	20.7	10.0	8.8
Imports of goods and services	-475.7	-63.4	14.1	4.0	0.7
GDP at market prices	250.0	100.0	85.	4.7	3.2

<u>Selected economic data, average</u> <u>change in per cent</u>	<u>1978</u>	<u>1979</u>	<u>1980</u>	<u>1981 1/</u>
Average earnings	21.7	24.9	25.5	18.0
Retail prices	7.4	9.5	13.5	11.1 2/
Domestic credit (end-year data)	24.0	25.9	20.1	10.0 3/
Money and quasi money (end-year date)	14.9	18.5	15.9	20.2 3/
Employment	3.4	3.0	1.3	...
Unemployment rate (in per cent; yearly average)	2.3	2.1	2.4	3.0

<u>Selected economic data, in</u> <u>per cent of GDP</u>	<u>1978</u>	<u>1979</u>	<u>1980</u>	<u>1981 1/</u>
Gross national saving	26.6	27.4	26.9	26.5
Private	25.3	26.6	27.4	28.0
Public	1.3	0.8	-0.5	-1.5
Gross domestic investment	35.4	36.5	34.8	33.2
Consolidated central government budget:				
Domestic revenue	19.6	19.6	21.4	22.4
Total expenditure (including net lending)	28.0	27.9	30.7	31.6
Budget balance	-8.4	-8.3	-9.3	-9.2
Foreign grants	2.7	2.1	1.7	1.4
Overall balance	-5.7	-6.2	-7.6	-7.8

	<u>1978</u>	<u>1979</u>	<u>1980</u>	<u>1981</u> <u>1/</u>
External public debt (year-end) <u>4/</u>	17.1	16.6	19.1	25.2
Of which:				
Central government debt	10.3	10.1	12.7	15.6
Debt service payments on external public debt as a ratio to exports of goods and services <u>4/</u>	3.5	4.8	5.6	6.6
Of which:				
Payments on central government debt as a ratio to exports of goods and services	1.5	1.8	2.6	3.8
<u>Balance of payments, in millions of SDRs</u>				
Exports, f.o.b.	261.1	326.7	376.0	419.3
Imports, f.o.b.	-546.6	-701.8	-829.6	-877.1
Trade balance	-285.5	-375.1	-453.6	-457.8
Net invisible payments	160.1	216.5	277.2	306.0
Current account balance	-125.4	-158.6	-176.4	-151.8
(In per cent of GDP)	-11.5	-11.5	-10.8	-8.7
Long-term capital	115.2	98.7	73.6	89.9
Short-term capital, including errors and omissions	18.6	35.0	10.8	2.8
Overall balance	8.4	-24.9	7.4	33.8
Gross official reserves (year-end)	281.0	284.0	305.0	387.3 <u>5/</u>
Months of imports, c.i.f. equivalent)	5.5	4.3	4.0	4.8 <u>5/</u>
SDR/Cyprus pound exchange rate (end of period)	2.185	2.196	2.149	2.008 <u>5/</u>
U.S. dollar /Cyprus pound exchange rate (end of period)	2.847	2.893	2.741	2.311 <u>5/</u>

Source: Data provided by the Cypriot authorities and staff estimates.

1/ Estimates.

2/ August 1981.

3/ September 1981.

4/ Central government (excluding IMF credits) and semi-public organizations.

5/ October 1981.

I. Domestic Economy

1. Introduction

The economic rehabilitation of Cyprus after the hostilities of mid-1974 ^{1/} has been remarkably rapid. Unemployment, which approached 25 per cent of the labor force in late 1974, has been reduced to around 2-3 per cent; real per capita output has risen by well over 40 per cent above the 1973 level; exports of manufactures have become the most dynamic components of foreign trade; and the island has resumed its role as a favorite tourist center. This impressive performance was facilitated by an ample supply of labor, wage moderation, especially in the initial phase of the reconstruction effort, expansionary financial policies and buoyant foreign demand.

In the course of 1979, however, the economy of Cyprus moved beyond the problems of recovery and rehabilitation to problems of inflation and external imbalance. The economy operated at full capacity, shortages of skilled labor became widespread and wage increases became excessive. The external current deficit widened to the equivalent of 11 1/2 per cent of GDP and inflation approached double digit figures. These developments can be ascribed in part to the increase in oil prices, but to a large extent they reflected factors of domestic origin. Financial policies, which were instrumental in reactivating the economy after the events of mid-1974, remained expansionary for too long and in fact encouraged speculative investment.

In early 1980 economic policy began to be tightened with the main objective of eliminating excessive domestic demand. Subsequently, the authorities drew up a short-term stabilization program--which formed the basis for a stand-by arrangement with the IMF in the first credit tranche. The objectives of the program were to reduce the external deficit on current account to a level which could be sustained over time and to lay the foundations for a deceleration in the rate of inflation. For the year from July 1980 to June 1981, the goal was to reduce the current external deficit to the equivalent of less than 10 per cent of GDP from 15 per cent in the preceeding year.

The Cypriot authorities sought to achieve their objectives mainly by demand management; their effort coincided with stable oil import prices and improved agricultural output, which helped to dampen inflationary pressures and to reduce the balance of payments deficit. The objectives

^{1/} The events of 1974 left the territory of Cyprus divided into two administrative zones. The area to the north of the demarcation line--accounting for 36 per cent of the island's land mass--passed out of the Government's control. This area contained in mid-1974, inter alia, two fifths of the total population of the cultivated area. At present there continues to be little movement of people or goods between the two zones. This report concerns only the area remaining under the Government's control.

as set in the stand-by arrangement were fully met; the current external deficit was contained to just under 8 per cent of GDP, to a large extent due to a fall in stock accumulation which has a large import component. The year-on-year rate of inflation as measured by the CPI in the program period was contained to the preceding year's level, though it fell from a peak of 16 per cent in July 1980 to around 10 per cent in the second quarter of 1981.

Progress toward internal and external adjustment during the program period was accompanied by a respectable rate of real GDP growth (3 1/4 per cent) and a further improvement in living standards without any significant increase in unemployment. Growth throughout the program period was export-led; domestic demand was reduced substantially, the burden initially falling on private consumption and stockbuilding, and subsequently extending to gross fixed investment. Public consumption bore only a slight part of the adjustment burden.

Wages and salaries for a substantial part of the labor force remained indexed to cost-of-living changes and rose by well over 20 per cent during the 12 months to June 1981. In addition, wage earners were the main beneficiaries of a reduction in income tax rates introduced in March 1981 with effect from the beginning of the year (see Chapter II). Even so, private disposable income increased by some 17 per cent in nominal terms and 4 per cent in real terms at about the same rates as in the preceding 12-month period. However, the weakening of consumption expenditure in the program period led to an increase in the savings ratio, thus allowing a rise in the domestic component of gross investment financing.

Growth in the second half of 1981 continued to be export-led, though domestic demand began to recover from the very depressed levels of the corresponding period of 1980. The unemployment rate inched up but remained low by international standards. Though the social partners did not reach agreement on an incomes policy, wage claims began to moderate in the second half of 1981; partly as a result, there was no significant acceleration in the rate of price inflation up until September 1981.

2. Developments in 1980 and 1981 ^{1/}

Real GDP growth, which had fallen from an average rate of over 20 per cent in 1976-77 to one of about 9 per cent in 1978-79, eased to just under 4 per cent in 1980-81 (Table 1). Economic developments during 1980-81 were influenced by the demand management policies, mentioned above. Between 1979 and 1981 the rate of growth of private consumption was reduced from 6.4 per cent to around zero, that of public consumption was about halved, and the volume of gross fixed investment fell by some 3 percentage points (Table 2). Stockbuilding, which had continued to add strongly to growth in the first half of 1980, fueled in part by speculation about

^{1/} The data for 1981 are provisional estimates of the Cypriot authorities.

further increases in import prices and excise taxes, was more than offset by destocking in the second half of the year. The level of stocks remained roughly unchanged in 1981.

On balance, total domestic demand eased considerably, its rate of growth falling from 7.2 per cent to 2.3 per cent in 1980 and to a negative 0.4 per cent in 1981. As a result, the gap between real aggregate demand and supply was reduced from 19.1 per cent in 1979 to 12.3 per cent in 1981 (Chart 1). The real rate of growth of imports of goods and services was reduced from 14.1 per cent to 0.7 per cent during the same period. The growth rate of exports of goods and nonfactor services was more than halved between 1979 and 1981 (from 20.7 per cent to 8.8 per cent). Nevertheless, the share of real exports of goods and nonfactor services in aggregate demand (gross domestic expenditure plus exports of goods and nonfactor services) increased to 30.6 per cent in 1981 from 27.3 per cent in 1979. The corresponding decline in the share of domestic demand reflected primarily a reduction in the shares of gross fixed investment and private consumption. The share of public consumption on the other hand increased slightly.

a. Domestic demand

(1) Consumption

On an annual basis, consumption expanded by 4.4 per cent in 1980 compared with 6.4 per cent a year earlier. Much of the growth in 1980 occurred in the first half of the year and coincided with a sharp rise in disposable incomes, though there was also a carry-over effect from the second half of 1979 when private consumption expenditure was extremely vigorous. The demand for consumer durables--notably motor vehicles--which early in the year was exceptionally high in anticipation of an increase in excise tax rates (see Chapter II), declined sharply in the wake of the tightening of credit policy, and later in the year was affected by increased levies on account of the reform of the social security system. As a result, private savings increased in the second half of the year, and for the year as a whole their ratio to disposable income at 28.9 per cent was still slightly higher than in the preceding year (Table 3).

Despite a measurable recovery in the second half of the year, the rate of increase of private consumption expenditure approached zero in 1981. This development was the result of both a reduction in the rate of growth of real private disposable income (from 6 per cent in 1980 to 3 per cent) and an increase in the private savings as a ratio to disposable income (from 29.0 per cent to 30 per cent), which was partly precautionary but may have also reflected the lessened need to replenish consumer durables.

In contrast, real consumption expenditure by the public sector increased at somewhat faster rates than real GDP in both 1980 and 1981. Much of the increase of 5 per cent in 1980 continued to be accounted for

by the rise in public service employment. In 1981 public consumption expenditure rose by 4.7 per cent, owing primarily to the rise in the purchase of goods and services, including defense spending. 1/

(2) Investment

The adjustment effort was accompanied by a fall in the volume of gross fixed investment in both 1980 and 1981. Outlays on machinery and equipment in 1980 declined for the second consecutive year, primarily on account of a fall in the volume of investment in manufacturing (Table 2). Labor shortages, rising production costs, and uncertainties with respect to future demand and competitiveness in foreign markets as well as increased difficulties of access in some foreign markets, combined to affect adversely business decisions. 2/ There was little new investment in the traditional mining lines (copper, asbestos, iron pyrites, etc.), 3/ but outlays for widening the capacity of quarrying materials remained relatively high. On the whole, investment other than in construction declined by 0.7 per cent in 1980, as against a decline of 2.3 per cent in 1979.

The real rate of growth of construction outlays in 1980 barely remained positive, despite a 13.9 per cent rise in nonresidential construction. Activity in the sector declined perceptibly in the second half of the year, as domestic demand for housing fell and soaring prices deterred foreign investment in dwellings. As a result, the share of residential building in the value of total gross domestic capital formation declined from 44.1 per cent in 1979 to 42.9 per cent in 1980. Public sector expenditure on construction, which include infrastructural works for irrigation and communications, increased by 6.4 per cent in value terms, compared with 59.3 per cent in 1979; the rate of growth of spending of the refugee housing scheme also declined from 21.5 per cent to 14.4 per cent in 1980 (see Chapter II).

The volume of gross fixed investment declined by an estimated 2.8 per cent in 1981. The only sectors where minimal rates of growth were registered were those in the priority sectors of manufacturing and

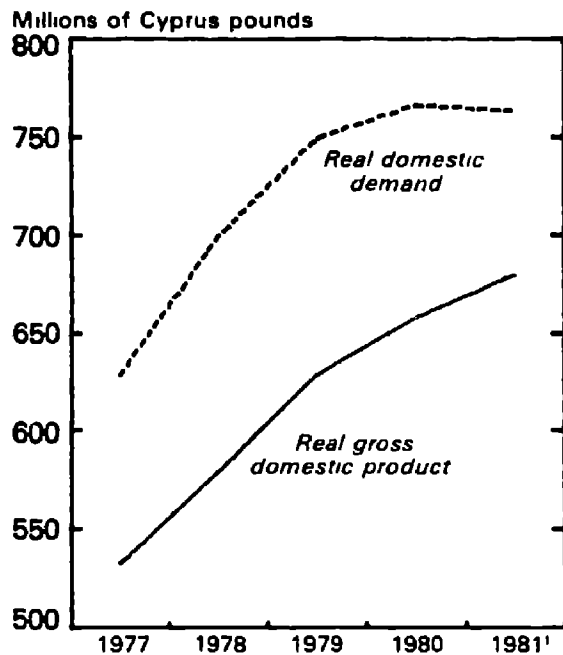
1/ To the extent that the deflator of public consumption does not fully reflect the increase in public wages and salaries, the growth of real consumption expenditure is overestimated.

2/ The number of applications for new industrial projects approved in 1980 by the Ministry of Commerce and Industry declined to 27 from 45 in 1979, 81 in 1979, 81 in 1978 and 201 in 1977. Estimated outlays for the new projects are expected to reach £C 2.8 million. By activity the approvals involved four metal structure projects; three furniture and carpentry factories; two projects each for food processing, clothing, shoes, leather products and crushing plants, while the remaining ten projects were for a wide range of activities.

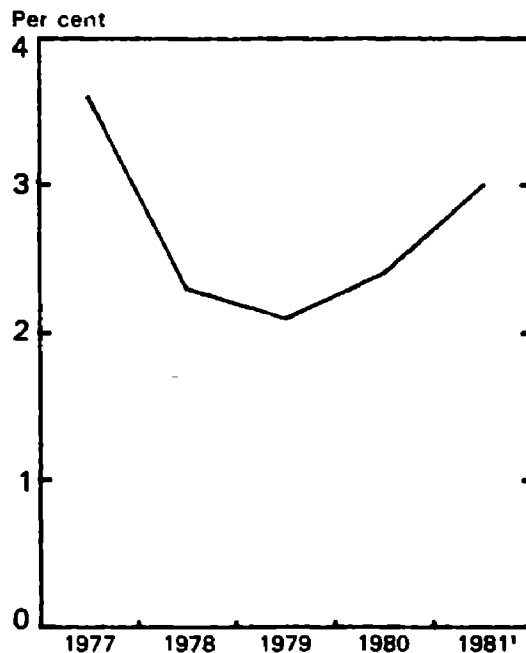
3/ The Geological Survey Department continued during 1980 its extensive mineral explorations, with a view to locating mineral deposits including sulphide needed for the operation of the new chemical and fertilizer plants now under construction.

CHART 1 CYPRUS SELECTED ECONOMIC INDICATORS

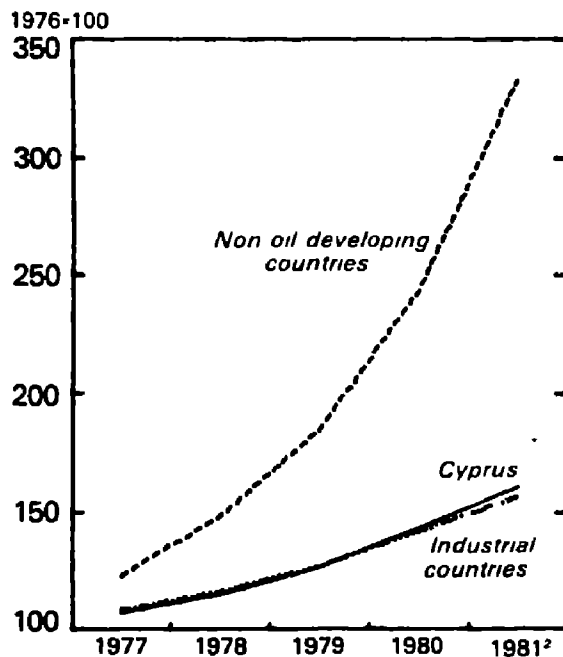
A REAL DOMESTIC DEMAND AND SUPPLY



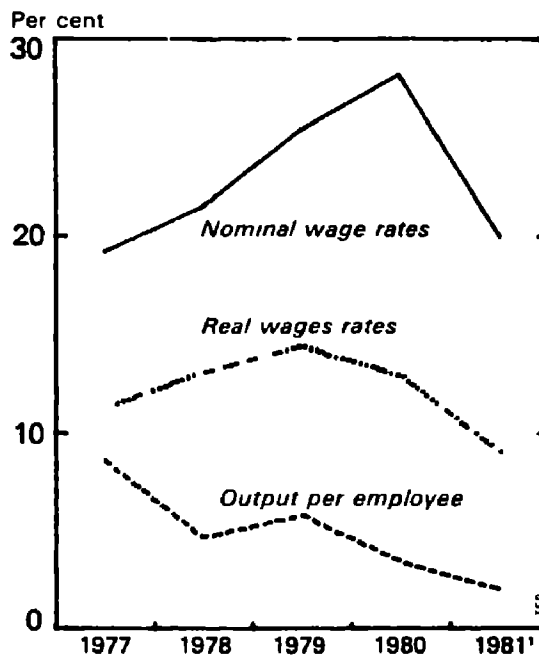
B UNEMPLOYMENT RATE



C. RETAIL PRICE INDICES



D. CHANGES IN AVERAGE WAGE RATES



Sources: Central Bank of Cyprus *Bulletin*; IMF *International Financial Statistics* and data provided by the Cypriot authorities

¹ Estimates

² August 1981

other export-related activities, such as hotel construction. These sectors were generally not affected by the ceilings on bank credit (see Chapter III), and enjoyed tax benefits in the form of accelerated depreciation allowances for plant and equipment and the doubling to 6 per cent of the tax deduction on income from exports. The demand for housing remained depressed; housebuilding was also affected by the slowdown in the public scheme for refugee housing. Furthermore, public infrastructural projects added little, if anything, to real fixed capital formation.

Stockbuilding played a leading role in the evolution of domestic demand during 1980; destocking in the second half of the year was sufficiently large to cause a fall of 2.4 per cent in the volume of gross investment for the year as a whole, as against an increase of 8.2 per cent in 1979. For 1981 as a whole, stockbuilding did not add to growth, as destocking in the first half was made good subsequently. The fall in the volume of investment in 1980-81 however, was accompanied by an improvement in its financing. Between 1979 and 1981, the share of domestic savings in total financing increased by about 9 percentage points to over 58 per cent, while that of factor income and transfers from abroad declined by about 4 percentage points; the share of net foreign finance fell by some 5 percentage points to slightly below 26 per cent (Table 3).

b. Output

(1) Primary sectors

Real output in the primary sectors, which had increased fairly strongly in both 1979 and 1980, declined in 1981 as a result of a sharp fall in activity in the mining and quarrying sector and less favorable conditions in agriculture. Real value added in agriculture rose by 5 per cent in 1980, slightly less than a year earlier and its share in real GDP at 11.4 per cent was unchanged from the previous year. The long-term downtrend in agricultural employment continued, and the share of farmhands in the total workforce declined to 24.6 per cent in 1980 from 25.1 per cent in 1979.

The volume of crop production increased by 3.7 per cent. Among the major crops only cereals, potatoes, and olives showed gains over 1979. Output of barley in 1980 was equal to 95 per cent of that preceding the hostilities of mid-1974, while output of wheat was equivalent to less than one fifth. ^{1/} Production of potatoes, which continued to be the main agricultural crop, increased by 10.6 per cent, facilitating an increase of 9 per cent in the volume of its exports. The volume of output of a wide range of fresh fruits and vegetables showed declines ranging from 3 per cent to over 10 per cent; the impact of this decline was reflected most vividly in the rise of the cost of living index (see section below) and also in exports (Chapter IV). Among livestock products only poultry, meat and egg production exhibited modest increases.

^{1/} The low wheat production is due to the loss of the prime wheat growing fields of the Messoria plain in the wake of the hostilities of 1974.

Agricultural output grew by only 0.7 per cent in 1981, as a result of reduction in the production of potatoes, olives and cereals. The output of fruit and vegetables increased sufficiently to exert a moderating influence on price developments in the first eight months of 1981. Except for output of sheep and goat meat, which fell sharply, all other meat production increased moderately in real terms in 1981.

In addition to the financing of a number of important irrigation projects underway or planned 1/ for the development of the agricultural sector, the Government offers various advisory services to farmers, including programs for improving quality and reducing costs, as well as low interest loans and subsidies for the promotion of certain crops with good demand prospects in the domestic and export markets and the stabilization of farmer incomes.

Real value added in mining and quarrying declined by 1.0 per cent in 1980, compared with an increase of 3.2 per cent in 1979. As a result, the share of this sector to real GDP declined to 1.6 per cent, from 1.8 per cent in 1979; employment also declined in 1980 when it accounted for only 1 per cent of the total labor force. Production of the traditional cupriferous ores was discontinued during 1980. Iron pyrites increased by 16 per cent to 53,600 tons, but were equivalent to only 11.6 per cent of the prehostilities level. Production of other exportable minerals (chrome ore and asbestos) 2/ remained depressed, mainly because of world demand conditions. Output of quarrying materials, which have become the main growth factor of the sector, maintained its strong upward momentum despite the slowdown in construction activity. In 1981, however, activity in this sector declined by 12.6 per cent, and the output of quarrying materials fell as a result.

(2) Industry

The rate of growth of real value added in industry decelerated from 11 per cent in 1979 to 4.6 per cent in 1980 and 2.2 per cent in 1981 primarily on account of the reduction in the rate of growth of the construction sector. Manufacturing output, accounting for nearly 55 per cent of real value added in industry, 3/ grew by 7.1 per cent in 1980, and 6.8 per cent in 1981, somewhat less than in 1979, displacing construction as the leading growth sector (Table 5).

1/ In advanced state of construction are the Paphos Irrigation Project, which is expected to double dam reservoir capacity by 1982, and the Pitsillia Rural Development Project; feasibility studies have been completed or will be shortly completed for the Vassilikos-Pendasvornos Projects, the Polis Watershed Project, the Kouris Delta Dam and, the largest of them all, the Southern Conveyor Scheme.

2/ The share of the sector in total domestic exports declined to 5.4 per cent from 6.6 per cent in 1979.

3/ In 1980 manufacturing accounted for 18.1 per cent of total GDP, 21.4 per cent of total employment, and 10 per cent of domestic exports.

As in previous years, manufacturing production in 1980 was directed more toward exports than the domestic market; the value of exports of manufactures, despite the adverse international economic environment, increased 6 per cent, while the gross value of output in manufacturing rose by 22.6 per cent. The figures for 1979 were 32.1 per cent for exports and 20.9 per cent for gross output (Table 6). Excluding petroleum products, the output of which increased by 80 per cent primarily due to price inflation, the main growth leaders were paper products, chemicals, and nonmetallic minerals. Textiles, clothing, and footwear, on which the recent industrial success in Cyprus largely rests, exhibited a more modest rate of growth, a reflection perhaps of the declining competitiveness of Cypriot goods vis-à-vis a number of newly industrializing countries in Asia and Africa. Transport equipment and food processing were the worst performers, the latter on account of the relatively poor harvests.

In 1981 foreign demand continued to be the driving force behind manufacturing activity. Production of wine products, footwear and cigarettes increased at a fairly rapid pace, while production in the canning industry, and of cement, bricks, and petroleum products showed substantial declines.

Manufacturing is dominated by family-based and relatively small-scale units; average employment per establishment has been increasing but was still below seven employees in 1980. Establishments with five or more employees predominate in the fields of food processing, tobacco, plastics, petroleum refining, and cement. The main constraints on the size of establishments are the small size of the domestic market, the scarcity of local sources of raw materials, technological and financial factors, and the family-based management style of most businesses.

The authorities recognize that a sustained rate of growth in manufacturing requires a reorientation of investment. For the medium term, they envisage the need for a major shift in investment priorities toward more capital-intensive and larger scale production. Construction of new industrial buildings in government-financed industrial estates and the provision and extension of infrastructures are important elements in the authorities' industrial strategy. Some fiscal measures have already been taken in order to facilitate the consolidation of small productive units into larger combines. Rules governing foreign investment are being reviewed to attract know-how and technology, and a free industrial zone has been completed. The authorities have been reviewing the tax regime to be offered to the industries which will operate in the zone. 1/

1/ Cyprus also hosts some 900 offshore companies--60 of which are physically located in Cyprus--providing a variety of services to neighboring countries in the Middle East and Africa. Partnerships are completely tax-exempt as are branches of overseas companies managed and controlled from abroad. Companies incorporated in Cyprus, whether or not managed or controlled from Cyprus, are liable to pay tax on assessable income at one tenth of the standard rate of 42.5 per cent.

Real value added in construction increased by 1.7 per cent in 1980 and declined by over 4 per cent in 1981, following increases of 15.4 per cent, 20.5 per cent, and 48.4 per cent in 1979, 1978, and 1977, respectively. The slowdown, in both the private and public sector was the combined result of a cyclical drop in activity, the dampening of speculative investment in the sector, and the credit squeeze especially since the second half of 1980, which affected primarily commercial buildings and private dwellings.

The activities of the newly instituted Land Development Organization (LDO) and the Housing Finance Organization (HFO) did not have yet any impact on building activity. In the years ahead, however, the industry may be significantly influenced by them. The main objectives of LDO is to acquire land suitable for residential development, provide all necessary services, and divide the land into building plots for sale to middle- and low-income groups at cost plus a set rate of return of about 15 per cent; in addition, it can erect low cost houses for the same groups. The HFO is to provide 15-year housing finance for low- and middle-income groups. Such loans, if secured by mortgages, would cover up to 75 per cent of the value of the house or if secured against savings deposits with HFO up to 90 per cent of such deposits. 1/

(3) Services

In the face of the general decline in the rate of growth of economic activity, the growth of output in the services sector slowed significantly since the second half of 1980. As a result, real value added in the services sector, which had increased by 8.8 per cent in 1979, rose by 4.9 per cent in 1980, accounting for just under 54 per cent of total GDP at factor cost. The slowdown was quite marked in wholesale and retail trade but was particularly significant in banking, insurance, and real estate. The rate of growth in real value added in services decelerated to 4.5 per cent in 1981; while there was some recovery in wholesale and retail trade as well as in banking and insurance, activity in all other service sectors declined perceptibly.

The tourist industry continued to make a strong contribution to economic activity; after increasing by 22 per cent in 1978 and 37 per cent in 1979, the number of long-stay visitors 2/ rose by 19 per cent to over 353,000 in 1980. The average length of stay was 10.4 days, slightly less than in 1979. This relatively good performance was accompanied by a further increase in employment (by 9.1 per cent to 10,364 persons) and in hotel capacity. During 1980 five new hotels and ten new hotel-apartments were put into operation, raising the total number of beds available by

1/ The Government intends to encourage deposits with the HFO by small depositor/savers as well as large ones (insurance companies, provident funds, etc.) through the extension of tax incentives.

2/ The number of one-day visitors declined by 18 per cent to just over 50,000 in 1980.

19 per cent to 10,927. In addition, work continued on a number of other projects which increased bed capacity by nearly 38 per cent in 1981 and will raise it by an additional 12 per cent in 1982. New records were established on the tourist sector in 1981; the number of arrivals is estimated to have increased by 20 per cent and employment by a further 4 per cent.

3. Energy

Cyprus depends almost entirely on imported sources of energy to satisfy its primary energy needs. The main energy sources are crude oil and refined oil products, which in 1980 accounted for over 96 per cent of total energy imports of £C 78.5 million (Table 7). With prices rising by 49.3 per cent (in terms of Cyprus pounds) and volumes by 17.6 per cent, the value of imports of oil and related products was 75.6 per cent higher than in 1979, amounting to 17.8 per cent of total imports (12 per cent in 1979). The increase in volume came after two years of severe destocking; 1/ in the first half of 1980 imports of crude oil were about 85 per cent higher than in the second half. Imports of refined oil products, on the other hand, were 18 per cent higher in volume in the second half than in the first.

Energy consumption in volume terms increased by only 2.3 per cent in 1980, following increases of 8.4 per cent and 10.5 per cent in 1978 and 1979, respectively. As a result, the income elasticity of energy consumption declined to 0.5 per cent in 1980 from an average of about 1.1 per cent in the preceding two years. The largest energy consumers were industry (41 per cent of total oil consumption), the transport sector (28 per cent), and the commercial and household sectors (28 per cent). Consumption declined by 6.6 per cent in the first half of 1981, as a result of the temporary shutdown of the cement factory, but recovered in the second half, and for the year as a whole it posted only a small decline in volume terms.

With almost total dependence on imported energy, policies have been geared to developing alternative energy sources and to making better use of energy through conservation. Much planning has been undertaken in both areas, and some measures have been introduced with some degree of success. These include the introduction of speed limits, more efficient traffic lights, the limitation of lorries on highways, and the reintroduction of daylight savings time in summer. More effective, however, have been the pricing policies and the fiscal measures introduced in 1980 including the increase of customs duties on automobiles across the board, and the imposition of an additional graduated tax on automobiles exceeding 1,000 cc. Petrol prices almost doubled in 1980; 2/ the price of gasoline in Cyprus

1/ Oil companies are required by law to keep stocks equivalent to two months of total consumption for purposes of national security.

2/ The price of premium gasoline was raised to £C 1.5 (roughly US\$3.50) per imperial gallon.

is high enough to fully subsidize all other users of fuel including liquid petroleum gas (LPG) 1/ which is widely used for cooking and heating.

The authorities are making serious efforts to use alternative imported sources of energy. A study on the practicality of using coal instead of oil in the production of electricity and cement is at an advanced stage. As regards local sources, some 35 per cent of households have water heating units activated by solar energy. The Government is giving serious consideration to providing incentives to encourage hotels, canning industries and greenhouses to make use of solar heating units. The use of solar energy for heating purposes may be made compulsory in schools and public buildings. The authorities estimate that in the medium term only about 2 per cent of total energy needs could be satisfied by solar energy. Wind energy, especially for wind-powered pumps, has been judged to offer limited scope. The generation of hydroelectric power in connection with the construction of irrigation dams is being explored, and the design and technology for relatively large bio-gas systems are being evaluated.

4. Employment and productivity

a. Labor market

The slowdown in activity since the second half of 1980 has been accompanied by a weakening in the demand for labor. After rising by 3.4 per cent and 3.0 per cent in 1978 and 1979, respectively, the total number of employed persons increased by only 1.3 per cent (to 176,500) 2/ in 1980 (Table 8). This latter increase was concentrated largely in services, where employment rose by 4.2 per cent, reinforcing a trend underway since 1976. Employment in industry declined slightly, with the number of those engaged in manufacturing rising at a considerably slower pace (0.5 per cent) than in earlier years, and employment in construction falling by 3.2 per cent for the first time in several years. After a temporary pause in 1979, employment in the primary sectors continued its declining trend falling in 1980, when it accounted for 25.6 per cent of the labor force or 2.2 percentage points less than in 1976. The share of employment in industry continued to hover around 32 per cent for the third consecutive year, or around 7 percentage points more than in 1976, while that of services approached 40 per cent in 1980, compared with about 37.5 per cent four years earlier.

The total labor force, meanwhile, increased by 1.6 per cent in 1980, reflecting an increase in the average number of people unemployed. The increase in the unemployment rate--from 2.1 per cent in 1979 to 2.4 per

1/ LPG--which is the major component of the limited amount of official trade across the ceasefire line--is sold at a subsidized price to the Turkish Cypriot community, while electricity is provided free of charge.

2/ Excluding temporary workers abroad. The number of such workers declined from 14,200 at end-1977 to 12,000 at end-1979 and 11,200 at end-1980, representing about 6 per cent of the domestic labor force.

cent in 1980--was the first since 1975; it was concentrated in the second half of the year, when the number of registered unemployed averaged 2.7 per cent of the labor force. Nearly all sectors of the economy were affected; however the number of unemployed construction workers more than doubled prompting the authorities to relax their previous policy regarding the temporary employment of skilled workers abroad. Particularly acute became also the problem of unemployed university graduates, for which plans to train them for middle and top positions in the tourist industry are being evaluated.

The easing of the labor market continued during 1981; the number of registered unemployed averaged 5,795 in the first eight months of the year, or just above 3 per cent of the labor force, compared with 2.1 per cent in the corresponding period of 1980 (Chart 1). The progressive easing of the labor market since mid-1980 is also brought out by two other indicators: the ratio of vacancies filled to vacancies notified, which increased from 23.8 per cent at end-1979 to 38.6 per cent at end-1980 and 46.7 per cent at end-August 1981; and the ratio of vacancies notified to registered unemployed, which declined from 29.5 per cent at end-1979 to 14.0 per cent at end-1980, and 9.1 per cent at end-August 1981.

The Government finances a number of programs for vocational and industrial training and encourages other programs, such as schemes for employing pupils during school vacation and for increasing mobility which has tended to diminish in response to narrowing wage differentials. Higher participation of women ^{1/} in the labor force is encouraged through flexible working conditions, the provision of more child care centers and other services.

b. Productivity

Only limited data on productivity are available, but a rough calculation of developments in recent years is given in Table 8. This measure of change in output per employee does not allow for changes in hours worked per employee, for which data are not available. Thus, while the measure overstates the growth in "true" productivity (i.e., output per man-hour) up to 1979, as average hours worked until then increased, it may understate the growth of productivity in 1980-81, when hours worked probably declined. The increase in output per employee--which had averaged 10.9 per cent in 1976-77 and 5.3 per cent in 1978-79--slowed to 3.4 per cent in 1980 and is likely to slow further in 1981 on the basis of preliminary estimates. In 1980, productivity increased in manufacturing and agriculture and declined in construction.

5. Wages and income determination

Despite the incipient easing in the labor market, the rate of growth of average wage rates increased from 25.4 per cent in 1979 to 28.2 per

^{1/} The share of female workers increased from 37 per cent of the employed in 1979 to 37.6 per cent in 1980.

cent in 1980, more than half of which was on account of automatic wage indexation. Wages in the government and semigovernment sectors rose slightly less than those in the private sector, where manufacturing posted an increase of 30.4 per cent following one of 29.1 per cent in 1979 (Table 8). In 1980, the increase in real average wage rates was 12.6 per cent, or nearly four times as large as the gain in productivity; this came in the wake of very substantial real wage rises in each of the preceding three years and at a time when the second oil price shock required an additional transfer of resources abroad. In the four years to 1980, the cumulative rise in average real wage rates exceeded 60 per cent, implying a significant improvement in the relative position of wage earners vis-à-vis other income recipients. However, given the high progressivity of income taxes and an increase in social security contributions larger than the rise in benefits, the growth of disposable income has been considerably lower than suggested by the unadjusted wage data (Table 3).

Income tax concessions were introduced in March 1981 (see Chapter II), retroactive to the beginning of the year, to reduce the tax burden of wage earners, which, in the view of the authorities "... during the last years has risen beyond desirable levels...." It would seem that these tax concessions are being to some extent taken into consideration by the trade unions in submitting their pay claims for 1981-82. Settlements of many of the two-year collective agreements that were up for renegotiation in 1981, including about ten pace setters in the semipublic sector, appear to have been somewhat more moderate. On balance, however, increases in average real wage rates still exceed productivity gains by a large margin (Table 8). On the other hand, the number of man-days lost in strikes was much lower than in 1980 (101,000 man-days) and 1979 (22,000 man-days), despite a strike wave that hit the economy early in the year.

All collective agreements, including those for civil servants, provide for a cost of living allowance tied to the price index, in addition to annual increments for seniority and negotiated overall wage increases. It is estimated that between 60 per cent and 70 per cent of the working population receive a cost of living adjustment. Wages are adjusted semiannually--in January and July--for movements in the six-month moving average of the retail price index. The reference base, i.e., total pay at end-1977, is adjusted to take into account increases in real wages which have taken place in the meantime so that the indexation mechanism now in effect allows full compensation for inflation.

6. Prices

Retail prices rose by 13.5 per cent, on average, in 1980 compared with increases of 9.5 per cent and 7.4 per cent in 1979 and 1978, respectively (Table 10). Some 27 per cent of the increase in the retail price index was accounted for by the direct effect of the oil price rise. 1/

1/ In 1979-80 the cumulative increase in the unit import value of oil and oil products exceeded 120 per cent in terms of Cyprus pounds.

Other important factors contributing to inflation in 1980 were the strong increases in the prices of "food and drink" and "miscellaneous services" such as education, medical care, and recreation.

After reaching a peak of 16 per cent in July 1980--when a significant adjustment was made to the price of fuels--the year-on-year rate of increase in retail prices declined to around 13 per cent in the last quarter of 1980 and to around 10 per cent in the second quarter of 1981, before reaccelerating to 10.5 per cent in the third quarter. The decline in the rate of inflation has coincided with the abating of domestic demand pressures, increased supplies of domestically grown foodstuffs and the stabilization of imported oil prices.

Wholesale prices, which had outpaced the rises in retail prices throughout 1980 and early 1981, have lagged behind them since the second half of 1981. ^{1/} The wholesale price index rose, on average, by 16.5 per cent in 1980, nearly double the rate of increase of 1979 and about four times faster than that of 1978. The index of the "home goods" group grew by 19 per cent in 1980, while that of the "imported goods" group rose by 11 per cent. The year-on-year rate of increase, slowed to around 8 per cent in the second quarter ^{1/} of 1981, before reaccelerating to 10 per cent in the third quarter.

The Government made persistent efforts during 1980 to contain the rise in prices due to factors of domestic origin. Increasing importance was given to the formulation of a voluntary price and incomes policy compatible with that objective. At the same time, control on prices for about 60 items, including food and drinks, pharmaceuticals, construction materials, petroleum products and spare parts for motor vehicles, continued in force. These are divided into two categories: those items for which a maximum sale price is set, and a number of other items for which a profit margin (around 15 per cent) on manufacturers' equity is allowed for. Prices are controlled by the Minister of Commerce and Industry in consultation with the Price Commission, established at the Ministry of Commerce in early 1974, when the first tendencies of accelerating inflation appeared in Cyprus. The Commission, which acts as an advisory body to the Minister, is composed of representatives of the Government, the Labor Unions and the Employers' Confederation.

^{1/} Wholesale price surveys are undertaken in January, April, July, and October.

Table 2. Cyprus: Gross Fixed Capital Formation, 1977-81

	1980 1/		1977 1978 1979 1980 1/				1981 1/
	In millions of Cyprus pounds; at current prices	In per cent of total	Annual percentage changes at constant 1979 prices				Estimates
Gross fixed investment	255.9	100.0	53.3	19.4	9.6	-0.1	-2.8
By sector							
Primary sectors	16.2	6.3	14.4	23.6	12.7	-19.8	...
Of which:							
Agriculture	14.8	5.8	19.1	25.0	14.3	-20.0	...
Industry	46.2	18.1	78.2	1.9	2.6	7.1	...
Of which:							
Manufacturing	24.6	9.6	86.8	1.5	-4.0	-15.3	...
Dwellings	109.8	42.9	48.4	26.5	17.3	-7.1	-5.3
Other sectors	83.7	32.7	56.0	22.1	3.0	10.9	...
Of which:							
Transport and commun- ications	40.2	15.7	61.7	29.9	-4.5	--	...
By type							
Construction	180.2	70.4	43.3	21.7	16.4	0.1	-2.3
Dwellings	109.8	42.9	48.4	26.5	17.3	-7.1	-5.3
Other	70.4	27.5	40.5	13.8	14.7	13.9	2.4
Machinery and equipment	75.7	29.6	71.7	15.6	-2.3	-0.7	-3.9
Motor cars	17.2	6.7	95.8	23.0	-3.5	-1.8	-19.8
Other	58.5	22.9	65.8	13.5	-2.0	-0.4	0.7

Source: Data provided by the Economic Studies and Research Section of the Ministry of Finance.

1/ Provisional.

Table 3. Cyprus: Private Appropriation Account, 1976-81

(In millions of Cyprus pounds)

	1976	1977	1978	1979	1980 1/	1981 1/ Estimates
GDP at market prices	327.6	421.9	508.5	628.6	750.0	858.7
Plus: Net factor income from abroad	14.0	18.5	20.4	22.3	25.3	20.2
Plus: Private transfers from abroad 2/	10.1	6.0	11.5	12.3	13.4	14.1
Plus: Transfers from budget 3/	33.2	36.5	43.2	46.5	74.9	89.8
Plus: Interest payments on domestic public debt	2.2	2.9	2.9	4.3	7.0	10.3
Less: Direct taxes	21.7	25.2	31.7	41.1	59.8	83.2
Less: Indirect taxes	24.6	37.9	47.2	60.4	70.0	75.4
Less: Other current government receipts	16.9	19.2	20.6	21.5	30.9	33.6
Private disposable income	323.9	403.5	487.0	591.0	709.9	800.9
Private consumption	239.7	304.8	358.4	423.6	504.5	560.4
Private gross savings	84.2	98.7	128.6	167.4	205.4	240.5
Memorandum items:						
Private savings as a percentage of:						
Disposable income	26.0	24.5	26.4	28.3	28.9	30.0
GDP	25.7	23.9	25.3	26.6	27.4	28.0
Disposable income as ratio to GDP	98.9	95.6	95.8	94.0	94.7	93.3

Source: Data provided by the Cypriot authorities; and staff estimates.

1/ Provisional.

2/ Includes local authorities and semi-government organizations; equal to net foreign transfers minus foreign grants for budget support.

3/ Subsidies and transfers from the consolidated central government budget minus interest payments on public debt, plus capital transfers and unallocable expenditures.

Table 4. Cyprus: Savings and Investment, 1976-81

(At current prices)

	1976	1977	1978	1979	1980 ^{1/}	1981 ^{1/} Estimates
(In millions of Cyprus pounds)						
Domestic savings ^{2/}	36.7	57.5	83.8	117.2	137.9	169.9
Factor income and transfers from abroad (net)	38.8	48.5	45.7	47.7	51.1	46.6
National savings	75.5	106.0	129.5	164.9	189.0	216.5
Public sector ^{3/}	-0.3	15.3	14.5	9.6	10.3	1.2
Private sector	75.8	90.7	115.0	155.3	178.7	215.3
Plus net foreign financing (= current account deficit)	4.2	35.9	58.6	72.6	81.0	75.0
Gross domestic investment	79.7	141.9	188.1	237.5	270.0	291.5
(In per cent of GNP)						
Domestic savings	10.6	13.0	15.8	18.0	17.8	19.3
Factor income and transfers from abroad (net)	11.2	11.0	8.6	7.3	6.6	5.3
National savings	21.8	24.0	24.4	25.3	24.4	24.6
Public sector	-0.1	3.5	2.7	1.5	1.3	0.1
Private sector	21.9	20.5	21.6	23.9	23.0	24.5
Plus net foreign financing	1.2	8.1	11.0	11.2	10.4	8.5
Gross domestic investment ^{4/}	23.1	32.1	35.4	36.5	34.8	33.2

Source: Data provided by the Economic Studies and Research Section of the Ministry of Finance.

^{1/} Preliminary.

^{2/} Domestic savings defined as GDP less domestic consumption.

^{3/} Defined as current domestic revenue plus foreign grants less total current expenditure of the consolidated Central Government. These data do not agree with the public sector's savings data in Chapter , mainly because of the exclusion of unallocable expenditures.

^{4/} The figures may not add up due to rounding.

Table 5. Cyprus: Origin of Gross Domestic Product, 1977-81

	1980 ^{1/}		1977	1978	1979	1980 ^{1/}	1981 ^{1/}	Estimates
	In millions of Cyprus pounds; at constant prices	In per cent of total						
Primary sectors								
Agriculture ^{2/}	78.5	13.0	1.5	-2.2	4.9	4.2	-1.0	
Mining and quarrying	69.0	11.4	0.9	-3.1	5.1	5.0	0.7	
	9.5	1.6	6.0	4.5	3.2	-1.0	-12.6	
Industry	200.1	33.2	26.8	14.1	11.0	4.6	2.2	
Manufacturing	109.2	18.1	16.6	10.3	8.0	7.1	6.8	
Construction	82.9	13.7	48.4	20.5	15.4	1.7	-4.2	
Power and water	8.0	1.4	9.7	7.4	6.8	2.6	7.5	
Services	324.7	53.8	13.9	7.9	8.8	4.9	4.5	
Transport and communications	48.6	8.1	18.2	6.1	10.0	10.5	3.1	
Wholesale and retail trade	92.7	15.4	22.5	8.5	10.0	1.2	3.5	
Banking, insurance, and real estate	34.9	5.8	24.3	21.4	7.9	-1.7	0.6	
Ownership of dwellings	29.6	4.9	4.7	5.7	6.6	7.2	3.4	
Public administration	43.0	7.1	-2.1	-1.3	3.7	10.5	7.9	
Other services	75.9	12.5	12.5	8.7	11.0	5.7	7.0	
GDP at factor cost	603.3	100.0	15.4	8.3	9.0	4.7	3.0	

Source: Data provided by the Economic Studies and Research Section of the Ministry of Finance.

^{1/} Provisional.^{2/} Includes forestry, fishing, and hunting.

Table 6. Cyprus: Gross Manufacturing Output
by Major Industries, 1976-80

	1980 ^{1/}		1976	1977	1978	1979	1980 ^{1/}
	In Millions of Cyprus Pounds	In per cent of total					
			Annual percentage changes				
Food	50.1	13.5	27.0	17.3	15.7	19.1	9.7
Beverages and tobacco	34.1	9.2	36.2	18.7	8.9	9.4	12.1
Textiles, clothing, and footwear	75.9	20.6	65.5	37.0	30.0	22.7	15.8
Petroleum products	54.0	14.5	42.2	20.3	-5.3	45.4	80.0
Paper products	11.2	3.0	106.7	28.1	52.7	52.5	46.7
Leather products	6.0	1.6	43.8	29.1	17.6	49.3	11.6
Chemicals	13.6	3.6	66.7	67.2	88.5	11.8	37.6
Metals and nonmetallic mineral products	55.2	14.8	62.4	30.9	18.3	29.7	21.3
Transport equipment	11.4	3.1	61.0	53.9	13.0	11.7	6.8
Miscellaneous	<u>60.8</u>	<u>16.3</u>	<u>70.1</u>	<u>-0.1</u>	<u>57.4</u>	<u>32.8</u>	<u>14.8</u>
Total	372.3	100.0	50.7	28.2	16.4	20.9	22.6

Sources: Department of Statistics and Research, Ministry of Finance, Quarterly Statistical Digest; and Central Bank of Cyprus, Annual Report 1980; and data provided by the Cypriot authorities.

^{1/} Provisional.

Table 7. Cyprus: Imports of Energy Products, 1977-81

	1977	1978	1979	1980	1981 Jan.-June
Total <u>1/</u>					
Value (in millions of Cyprus pounds)	35.2	31.0	44.5	78.5	52.0
Value (in 1976 prices)	32.8	31.2	31.3	35.7	18.3
Unit value index	107.3	99.4	142.0	219.8	284.3
Crude petroleum					
Value (in millions of Cyprus pounds)	17.5	17.8	23.5	47.3	31.8
Price (in Cyprus pounds per gallon)	0.162	0.152	0.190	0.314	0.423
Volume (in millions of gallons)	107.9	117.2	124.0	150.6	75.1
Year-on-year percentage change	5.0	8.6	5.8	21.4	-23.1
Refined petroleum products					
Value (in millions of Cyprus pounds)	16.4	12.1	19.6	28.3	18.1
Price (in Cyprus pounds per gallon)	0.165	0.147	0.252	0.327	0.420
Volume (in millions of gallons)	99.3	82.3	77.7	86.6	43.0
Year-on-year percentage change	49.3	-17.1	-5.6	11.4	8.3
Other <u>1/</u>					
Value (in millions of Cyprus pounds)	1.3	1.1	1.4	2.9	2.1

Sources: Ministry of Finance, Import and Export Statistics; and data provided by the Cypriot authorities.

1/ Includes manufactured gas.

Table 8. Cyprus: Labor Force by Sector, 1976-80

	1976	1977	1978	1979	1980	1976	1977	1978	1979	1980
	In thousands, period averages					In per cent of total				
Employed										
Primary sectors	47.5	47.7	46.5	46.5	46.2	27.8	28.1	26.8	26.1	25.6
Agriculture	45.2	45.4	44.5	44.7	44.5	26.5	26.8	25.7	25.1	24.6
Mining	2.3	2.3	2.0	1.8	1.7	1.3	1.3	1.1	1.0	1.0
Industry	42.6	50.6	55.6	58.4	58.1	25.0	29.8	32.1	32.8	32.1
Manufacturing	30.4	33.7	36.8	38.3	38.5	17.8	19.8	21.3	21.5	21.3
Construction	10.9	15.6	17.4	18.7	18.1	6.4	9.2	10.0	10.5	10.0
Power and water	1.3	1.3	1.4	1.4	1.5	0.8	0.8	0.8	0.8	0.8
Services	63.8	65.3	67.1	69.3	72.2	37.4	38.5	38.8	39.0	39.9
Transportation and communication	7.5	7.6	7.8	8.0	8.3	4.4	4.5	4.5	4.5	4.6
Wholesale and retail trade	17.0	17.5	17.9	18.6	19.1	9.9	10.3	10.3	10.5	10.6
Banking, insurance, and real estate	3.2	3.3	3.4	3.5	4.0	1.9	1.9	2.0	2.0	2.2
Public administration	10.7	11.0	11.3	11.7	12.1	6.3	6.5	6.6	6.6	6.7
Other services	25.4	25.9	26.7	27.5	28.7	14.9	15.3	15.4	15.4	15.8
Total employed	153.9	163.6	169.2	174.2	176.5	90.2	96.4	97.7	97.9	97.6
Unemployed	16.8 ^{1/}	6.1	4.0	3.7	4.3	9.8	3.6	2.3	2.1	2.4
Total labor force	170.7	169.7	173.2	177.9	180.8	100.0	100.0	100.0	100.0	100.0
Memorandum items:										
British military authorities	4.5	4.1	3.9	3.9	3.8					
Cypriots working abroad	...	14.2	13.0	12.1	11.2					

Sources: Central Bank of Cyprus, Annual Report 1980; and data provided by the Cypriot authorities.^{1/} Including 2,300 nonregistered unemployed.

Table 9. Cyprus: Wage and Productivity Indicators, 1976-81

(Percentage change over previous year)

	1976	1977	1978	1979	1980 ^{1/}	1981 ^{1/} Estimates
Average wage rates ^{2/}	<u>7.8</u>	<u>19.2</u>	<u>21.5</u>	<u>25.4</u>	<u>28.2</u>	<u>20.0</u>
Of which:						
Agriculture	11.3	16.7	13.7	29.0	28.4	
Manufacturing	9.4	24.2	23.3	29.1	30.4	
Construction	0.8	22.9	29.1	21.4	28.6	
Trade	13.0	20.5	21.1	23.0	27.9	
Government (wage earners)	2.3	25.8	21.2	24.0	27.8	
Memorandum item:						
Average real wage rate ^{3/}	3.9	11.2	13.1	14.4	12.6	9.0
Average earnings	<u>10.7</u>	<u>22.6</u>	<u>21.7</u>	<u>24.9</u>	<u>25.5</u>	<u>18.0</u>
Of which:						
Agriculture	8.1	13.3	21.3	31.5	30.9	
Manufacturing	14.4	25.2	21.9	27.7	23.6	
Construction	6.7	28.6	34.0	16.1	24.6	
Trade	14.9	23.3	21.7	20.7	27.1	
Output per employee ^{4/}	<u>13.1</u>	<u>8.6</u>	<u>4.7</u>	<u>5.8</u>	<u>3.4</u>	
Of which:						
Agriculture	9.3	0.5	-1.1	4.7	5.4	
Manufacturing	8.8	5.1	1.0	3.7	6.6	
Construction	43.7	3.7	8.1	7.3	5.1	

Sources: Department of Statistics and Research, Ministry of Finance, Quarterly Statistical Digest; and Central Bank of Cyprus, Annual Report 1980.

^{1/} Provisional

^{2/} Based on surveys conducted in October of each year.

^{3/} Deflated by the retail price index.

^{4/} Output as measured by GDP at constant prices.

Table 10. Cyprus: Prices Indices, 1973-81

(Percentage changes over preceding year or corresponding period of previous year)

[illegible]

Sources: Central Bank of Cyprus, Bulletin; and International Financial Statistics.

II. Public Finance

1. Introduction

In the aftermath of the events of mid-1974, fiscal policy resumed particular importance; since then, fiscal policy has been extensively used to reactivate the economy and to help realize development and social objectives. The Government replaced the five-year development plan framework of economic planning by a sequence of Emergency Economic Action Plans of shorter durations. An overriding priority has been attached to meeting the exceptional needs of the displaced people, especially with regard to housing. The development objectives of the Government have focused on replacing and improving the infrastructural facilities. Great importance has also been given to the agricultural sector, mainly through irrigation projects, and to transportation and communications. Direct public investment in productive capital formation has been limited, reflecting the authorities' preference not to intervene in areas where the private sector can provide a satisfactory development. Instead, fiscal and monetary incentives have been extensively used to encourage private investment. The social objectives included securing a minimum standard of living for all citizens and gradually obtaining a more equitable income distribution. Immediately after mid-1974, a large number of people were depending on aid in kind from the Government and successful efforts have been made to replace this aid by reactivating and expanding ordinary social benefit programs. In addition, substantial amounts have been allocated to the health and education sectors.

The public sector in Cyprus consists of the consolidated central government (the Government) and the rest of the public sector. The Government conducts its operations through (a) the ordinary budget (Tables 15 and 16) which contains most of the Government's customary current expenditure and tax and nontax revenue; (b) the development budget ^{1/} (Table 15) which administers most of the Government's capital expenditure; (c) the Public Loans Fund (Table 17) which undertakes the bulk of the Government's net lending to both the rest of the public sector and the private sector; (d) the Social Insurance Funds ^{2/} (Table 18) which manage the provision of pensions and unemployment benefits and receive the contributions for that purpose; and (e) the Special Relief Fund for Displaced Persons (Table 19). The Special Relief Fund was created in 1974 specifically in order to administer the emergency expenditure arising in connection with the refugee problem and to act as the recipient for funds (including grants) channelled to the Government for that purpose; it also engages in investment expenditure, mainly housing construction. The operations of these individual budgets and funds are combined together in the consolidated central government budget (Tables 12 and 13). The rest of the public sector includes (a) the government agencies; (b) the public corporations; and (c) the local authorities.

^{1/} Prepared by the Planning Bureau of the Ministry of Finance.

^{2/} Consolidated account of the Social Insurance Fund, the Central Holiday Fund, the Redundancy Fund and the Unemployment Benefit Account.

The rapid expansion in government expenditure after 1973 was not matched by a similar increase in revenue (Chart 2). With the exception of the period 1974-76, ^{1/} domestic revenue as a ratio to GDP remained rather stable around 19.2 per cent. The increasing revenue trend in 1980 and 1981 reflected the higher social insurance contributions required under the new earnings-related social insurance scheme introduced in October 1980; as a result, the share of direct tax revenue in total tax revenue increased substantially in the last two years (Table 11 and Chart 2). In addition to the dislocation of the economy, the revenue base became severely eroded by fiscal incentives geared toward stimulating the economy; furthermore, tax evasion remained a serious problem. On the other hand, total expenditure as a ratio to GDP increased by almost 10 percentage points, from 21.9 per cent in 1973 to an estimated 31.6 per cent in 1981. Current expenditure constitutes the bulk of total expenditure while its share is on an increasing trend; from 74.6 per cent in 1979, current expenditure reached an estimated 80.0 per cent of total expenditure in 1981, on account mainly of the increasing payments on wages and salaries and on subsidies and transfers (Chart 3). Consequently, the share of capital expenditure is falling, while at the same time, more than 50 per cent of them represent housing expenditure by the Special Relief Fund for Displaced Persons.

Since mid-1977, when the economy was rapidly approaching full capacity output, efforts have been made to gradually reduce the expansionary impact of fiscal policy and to restore public savings. Hence, the stimulus provided by the difference between domestic revenue and total expenditure (budget deficit excluding grants) as a ratio to GDP was sharply reduced from 12.6 per cent in 1976 to an average of 8.4 per cent for the period 1977-79. In 1980 fiscal policy turned out to be more expansionary than intended, due entirely to current expenditure overruns increasing the budget deficit (excluding grants) by 1 percentage point to 9.3 per cent of GDP. In 1981 the budget deficit is estimated to have been contained at the same percentage to GDP as in 1980. Reflecting the declining importance of foreign grants, the overall budget deficit, after a substantial improvement in 1977, followed an increasing trend (Chart 2 and Table 11) rising from 2.8 per cent of GDP in 1977 to an estimated 7.8 per cent in 1981. The current account balance (government domestic savings) ^{2/} remained negative throughout the period since 1973, and since 1979 it has been following a deteriorating trend.

^{1/} Because of the decline in nominal GDP in 1974 and 1975 (in 1976 nominal GDP was still lower than its 1973 level) the ratios to GDP of all variables in Chart 2 for the period 1974-76 are atypical.

^{2/} The current balance is given by the difference between current revenue (capital revenue is almost nil) and current expenditure. The latter is the sum of the ordinary budget expenditures, the unallocable expenditures, the expenditures of the Social Insurance Funds and the current expenditures of the development budget, and the Special Relief Fund.

The inflow of foreign grants alleviated somewhat the financing of the deficit, but still, because of the limited potential for domestic non-bank financing, the Government had to resort to considerable domestic bank and foreign borrowing to finance its overall budget deficit (Table 11). In the last two years, central bank financing approached its legal limit of 55 per cent of the estimated ordinary budget revenue, resulting in an acceleration of foreign borrowing. This increased the Central Government's foreign debt to an estimated 16 per cent of GDP in 1981 while total debt (both foreign and domestic) is estimated to have risen to a peak of 32.4 per cent of GDP. As a result, debt service payments on the Central Government's total debt, as a ratio to GDP, more than doubled in the last four years, reaching an estimated 3.1 per cent of GDP in 1981 (Chart 3).

In July 1980, the Cypriot authorities embarked upon a one-year stabilization program supported by use of Fund resources in the first credit tranche, aimed at reducing the current external deficit to a sustainable level over time, laying in the process the foundations for a reduction in the inflation rate. In terms of the stabilization program, the overall budgetary policy was formulated to support both the desired reduction in consumption and the need to limit the domestic credit expansion. In particular, the stabilization program entailed a substantial reduction in the ratio of the overall budget deficit to GDP from 6.3 per cent in 1979/80 to about 2.9 per cent ^{1/} in 1980/81; the program also envisaged a 2 percentage point increase in the tax ratio to GDP to 18.7 per cent and a substantial improvement in public sector savings. In addition, a hiring freeze was imposed on the civil service and the Government undertook to assess the feasibility of a 10 per cent reduction across the board in total expenditure. In the event, the objectives of fiscal policy turned out to be too ambitious; current expenditure and subsidies in particular exceeded by far their program levels. As a result, the overall deficit, instead of being substantially reduced, increased slightly to 7.0 per cent of GDP, while the current balance of the budget deteriorated even further; the tax ratio to GDP, however, increased modestly to 17.8 per cent.

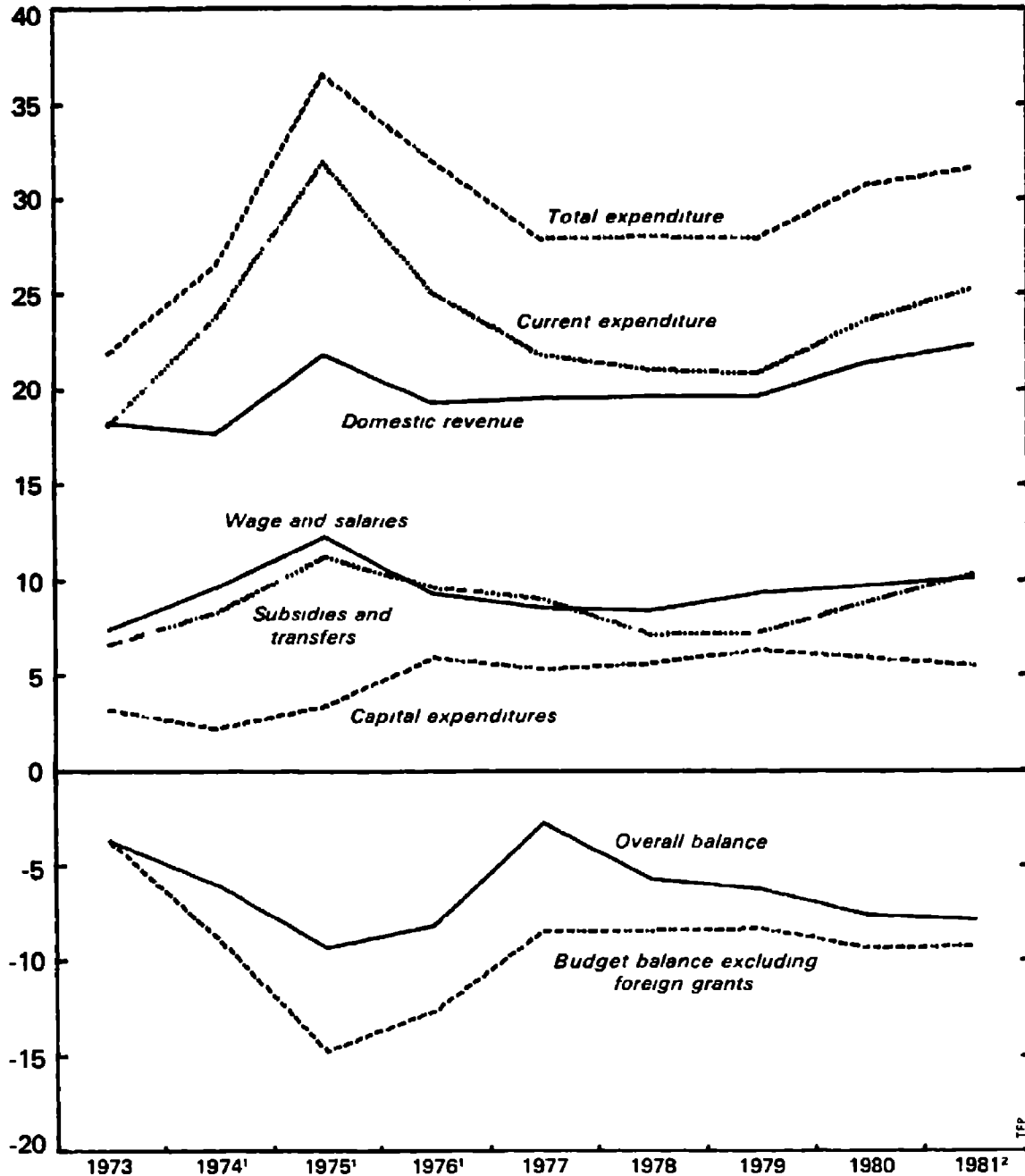
2. Fiscal developments in 1980-81

Among the major objectives of the Third Economic Emergency Plan for 1979-81 was to reduce the budget deficit so as to moderate the expansionary impact of the public sector on the economy. The distribution between current and capital expenditure was to be altered to increase public savings. In view of the inelasticity of a large part of the expenditure, especially in the ordinary budget, and the need to complete sizable development and social programs already embarked upon, the implementation of these objectives was to be gradual. The fiscal outturn for 1979, the first year of the program, exerted a stronger expansionary impact than intended. The growth of domestic revenue and total expenditure, including net lending, accelerated slightly relative to 1978 but their ratios

^{1/} Due to a new presentation of the budget, the 2.9 per cent of GDP deficit is equivalent to the 1.2 per cent of GDP deficit envisaged under the program.

CHART 2 CYPRUS CONSOLIDATED CENTRAL GOVERNMENT BUDGET, 1973-81

(In per cent of GDP)

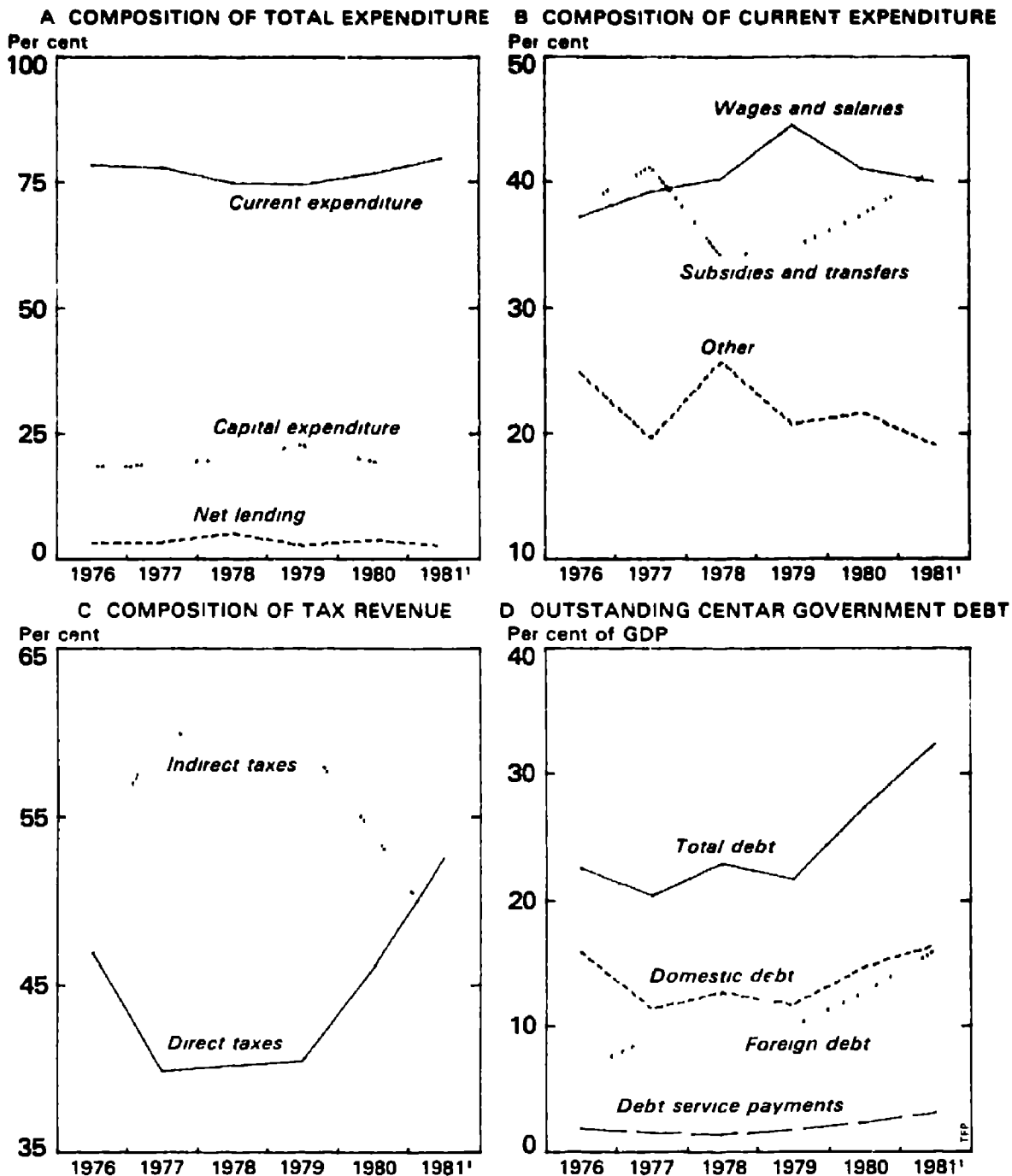


Source Data provided by the Cypriot authorities

¹For these years all ratios are atypical because of the sharp decline in nominal GDP in 1974 and 1975
nominal GDP in 1976 was still lower than its 1973 level

²Estimates

CHART 3 CYPRUS CONSOLIDATED CENTRAL GOVERNMENT BUDGET, 1976-81



Source Data provided by the Cypriot authorities

¹ Estimates

to GDP remained the same at 19.6 per cent and 27.9 per cent, respectively. Consequently, the ratio to GDP of the budget deficit excluding grants remained unchanged at 8.3 per cent; the marginal decline in grants, however, increased modestly the overall balances to 6.2 per cent of GDP (Tables 11, 12, and 14).

a. Fiscal developments in 1980

The main objectives of the Government's budgetary policy in 1980 remained those contained in the Third Emergency Plan. The quantitative fiscal targets for 1980 reflected, for the second half of the year, the targets of the one-year stabilization program embarked upon by the authorities in July 1980. The consolidated central government budget, as amended by the tax measures ^{1/} introduced in early 1980, provided for an acceleration in the rate of growth of domestic revenue and a deceleration in the growth of total expenditure, allowing a 2 1/2 percentage point reduction in the ratio of the overall budget deficit to GDP to 3.6 per cent.

The actual fiscal developments in 1980, however, fell short of the overall budget objectives. Although both domestic revenue and total expenditure exceeded their budgeted levels, the expenditure overrun was larger, resulting in an 1 percentage point increase in the budget deficit (excluding grants) ratio to GDP to 9.3 per cent. The ratio of the overall budget deficit to GDP increased by almost 1 1/2 percentage points to 7.6 per cent, given the slight reduction in grants. Domestic revenue increased by 30.5 per cent, compared with an average growth of 22.3 per cent recorded in the previous two years, raising the ratio of domestic revenue to GDP by almost 2 percentage points to 21.4 per cent. The growth of total expenditure accelerated to 31.6 per cent, more than two and a half times its budgeted growth; as a result, the ratio of total expenditure to GDP increased by almost 3 percentage points to 30.7 per cent. The expansion of total expenditure was accompanied by an acceleration of current expenditure and a deceleration in capital expenditure, resulting in an increase in the share of the former in total expenditure by nearly 2 1/2 percentage points to 76.9 per cent and an equivalent reduction in the share of the latter to 19.3 per cent. The current balance of the budget deteriorated substantially, government dissavings reaching 2.2 per cent of GDP (Tables 11, 12 and 14).

^{1/} The tax measures enacted in March 1980 involved a package of indirect tax measures and a tax on immovable property, estimated to yield about £C 9 million; the tax measures included an increase from 2 per cent to 3.5 per cent in the temporary import levy, the revenue of which accrue to the Special Relief Fund. A capital gains tax, designed, apart from its revenue effects, to reduce both land speculation and the attractiveness of an economically unproductive investment outlet, was also introduced in June 1980.

The expenditure overrun was entirely due to current expenditure which increased by 35.6 per cent, a sharp acceleration relative to the 22.6 per cent growth rate in 1976. This acceleration was the result of the substantial expansion of subsidies and transfers, and of unallocable expenditure. The latter, which constitute mainly transfers to semipublic organizations, increased from £C 3.0 million in 1979 to £C 13.1 million in 1980. Subsidies and transfers nearly doubled their growth rate from 25.1 per cent in 1979 to 45.8 per cent in 1980 (the fastest growing element of total expenditure), accounting for the doubling of the grain and vine 1/ subsidies; the 34.6 per cent increase in interest payments on public debt, reflecting the expanding foreign and domestic public debt (Table 15); and the 35.6 per cent increase in social insurance benefits, due partly to the introduction in October 1980 of a new earnings-related social insurance scheme (Table 18). The growth of wages and salaries decelerated substantially to 24.5 per cent relative to their peak growth of 35.9 per cent in 1979, whereas goods and services recorded a modest growth of 5.4 per cent. The growth of the ordinary budget expenditure, which comprises more than 70 per cent of current expenditure, slowed down slightly to 29.0 per cent, 2/ less than the 35.6 per cent growth of current expenditure; the higher growth of the latter resulted from the more than quadrupling of unallocable expenditure and the substantial acceleration of the expenditures by the Social Insurance Funds, from 18.7 per cent in 1979 to 34.9 per cent in 1980.

Development budget expenditure decelerated substantially in 1980, its growth rate falling to 13.2 per cent compared to its peak rate of 45.6 per cent the previous year; the low growth is accounted for by the levelling off of expenditure on agriculture (expenditure on the Paphos Irrigation Project actually declined) and on transport and communications (Nicosia-Limassol Highway) (Table 15). Expenditure by the Special Relief Fund slowed down as well, increasing by 13.0 per cent relative to 19.7 per cent in 1979. The rate of growth of expenditure on the refugee housing scheme 3/ declined from 21.5 per cent in 1979 to 14.4 per cent in 1980. As a result, capital expenditure, more than half of which constitutes housing expenditure, 4/ increased by 11.8 per cent, a growth rate more than three times less than the previous year's rate.

1/ Out of the £C 15.3 million of subsidies in 1980, about £C 5.0 million are producer subsidies to vine growers; the rest are consumer subsidies on grain. The existing system of grain subsidies makes up the difference between the fluctuating prices of supply which largely depends on imports and the fixed prices for domestic sales by the state monopoly.

2/ Apart from subsidies and interest payments on public debt, other main outlays of the ordinary budget are public order and safety, education, health, and welfare and social services (Table 15).

3/ Out of the 180,000 homeless refugees in 1974, 110,000 were adequately housed through the refugee housing scheme by the end of 1980.

4/ To help meet the housing needs of the middle- and low-income groups, constrained by the rising building costs, land speculation and the limited accessibility to bank financing, the Government set up in 1980 a Land

The substantial acceleration of domestic revenue in 1980, which increased by 30.5 per cent relative to an average of 22.3 per cent in the previous two years, was due to the acceleration of direct tax revenue and nontax revenue. Owing to the improvement in the revenue situation of both the Social Insurance Funds and the Special Relief Fund, direct taxes increased by 45.5 per cent, compared to an average growth of 27.7 per cent in the previous two years. Nontax revenue, because of the expansion of the nontax revenue of the ordinary budget, increased by 43.7 per cent relative to 4.4 per cent in 1979. Indirect taxes decelerated substantially, their growth rate falling from 28.0 per cent in 1979 to 15.9 per cent in 1980. As a result, the share of direct taxes in total tax revenue increased by 5 1/2 percentage points to 46.1 per cent, raising the tax ratio to GDP to 17.3 per cent (Tables 11, 12 and 14).

The relatively slow growth of the ordinary budget revenue of 22.5 per cent reduced its share in total domestic revenue to 77.8 per cent, down from 82.9 per cent in 1979. The slowdown in ordinary revenue was due to the substantial deceleration in the growth of both direct and indirect taxes (Table 16). Direct tax revenue increased by 25.7 per cent, compared with 36.6 per cent in 1979. Legislation for an immovable property tax and a capital gains tax was introduced in 1980, but it is expected that substantial revenues from these taxes will be realized only from 1981 onward. ^{1/} Direct taxes on income and profits increased by 31.2 per cent, relative to 41.4 per cent in 1979. Direct taxes on companies increased only modestly by 9.0 per cent after having been more than doubled in 1979, following the introduction of a system of collection on a current year basis; however, direct taxes paid by individuals nearly doubled their growth rate to 42.0 per cent, constituting 72.9 per cent of total taxes on income and profits. On the other hand, the indirect tax revenue of the ordinary budget increased by 12.0 per cent, down from the 27.6 per cent increase in 1979 mainly because of the very modest growth of excise taxes. Despite the increase in excise tax rates for petroleum products and motor vehicles, receipts from excise taxes decelerated from their 51.6 per cent growth rate in 1979 to 4.2 per cent in 1980. Receipts from the excise tax on motor vehicles declined by 9.3 per cent, reflecting a small decline in motor vehicle registrations and some movement toward

^{4/} (cont'd from p. 5) Development Organization and a Housing Finance Organization. The main objective of the former is to develop residential building plots and to provide low-cost housing to middle- and low-income groups. The Housing Finance Organization is to provide long-term housing financing to the same income groups. Both institutions will become operational in 1982 and are to be self-financed with no budgetary implications, apart from an £C 1 million budgetary grant (though not yet transferred). In the future they could affect budget revenues indirectly in the form of tax incentives for deposits with the Housing Finance Organization or possible interest subsidization of loans.

^{1/} Thus, while £C 6 million of immovable property tax revenue is budgeted for 1981, only £C 0.6 million was received from this tax in 1980.

the registration of smaller capacity vehicles, in line with the legislated increase in the component of excise tax paid according to engine size. Revenue from customs duties rose by 19.8 per cent, in line with the growth of imports. The nontax revenue increased by 55.7 per cent, mainly due to the more than doubling of the central bank profits transferred to the ordinary budget (Table 16).

The acceleration in the rate of growth of total direct taxes stemmed exclusively from the improvements in the revenue situation of both the Social Insurance Funds and the Special Relief Fund. Following the introduction of the new earnings-related social insurance scheme in October 1980, social insurance contributions for 1980 increased by 45.6 per cent, more than twice their growth rate in 1979; the higher contributions required under the new legislation should result in a surplus of revenue in the first years of operation of the scheme. ^{1/} The receipts of the Special Relief Fund (excluding government contributions), on the other hand, more than doubled, increasing from £C 7.1 million in 1979 to £C 16.3 million in 1980. The receipts of this fund consist almost exclusively of the mandatory contributions by employers and self-employed and the temporary import levy. Following the Supreme Court decision in November 1979 about the constitutionality of the relevant law, mandatory contributions more than trebled, increasing by £C 6.6 million to £C 9.5 million, as many of those liable started paying their full contributions in 1980 (Table 19). Revenue from the temporary import levy (part of indirect tax revenue) increased by 77.8 per cent to £C 6.4 million, as a result of the increase in the import duty from 2.0 per cent to 3.5 per cent.

The overall budget deficit at £C 57.1 million was by 47.2 per cent higher than in 1979, and as a ratio to GDP. It increased by almost 1 1/2 percentage points to 7.6 per cent (Tables 11 and 20). Net domestic borrowing declined, covering 45.7 per cent of the overall deficit compared to 88.9 per cent in 1979. The sale of government securities at £C 4.5 million, was at the same level as in 1979, whereas the sale of Treasury bills increased from £C 4.6 million in 1979 to £C 31.5 million in 1980. While nonbank financing declined substantially, bank financing increased by 22.9 per cent relative to 1979, covering 38.5 per cent of the deficit and accounting for the substantial increase of domestic credit to the public sector. Central bank financing of the budget deficit approached its statutory limit. ^{2/} As a result, net foreign borrowing nearly trebled relative to 1979, financing 54.5 per cent of the overall deficit, its ratio to GDP increasing from 1.7 per cent in 1979 to 4.1 per cent. Net IMF transactions were slightly negative in spite of the drawing of the

^{1/} It is estimated that by 1990, the cumulative surplus of the Social Insurance Funds will reach about £C 568.7 million, including government contributions.

^{2/} The Government can borrow from the Central Bank 55 per cent of its estimated ordinary revenue, 25 per cent of it in advances and 30 per cent of it in Treasury bills.

first credit tranche because of existing repurchase obligations. The net domestic and foreign borrowing allowed a quadrupling of advances to the Cooperative Central Bank, from £C 3.2 million in 1979 to £C 12.5 million in 1980, to improve its liquidity position. The substantial increase of both domestic and foreign debt led to a sudden jump of the ratio of the central government debt to GDP from 21.7 per cent in 1979 to 27.3 per cent in 1980 (Table 21 and Chart).

b. Fiscal developments during 1981

The overall budgetary policy for 1981 reflected the quantitative targets of the one-year stabilization program embarked upon in July 1981. The budget for 1981, as amended by the tax-relief measures of April 1981 (but effective from January 1981), ^{1/} provided for a 2 percentage point increase in the ratio of domestic revenue to GDP to 23.4 per cent; total expenditure was budgeted to increase by only 2.0 per cent in nominal terms, implying a substantial reduction in real terms, so that the ratio of total expenditure to GDP would fall by more than 3 1/4 percentage points to 27.4 per cent. As a result, the budget deficit, excluding grants, was expected to decline by 5 1/2 percentage points to 3.9 per cent. Similarly, the overall deficit was to decline to 2.4 per cent of GDP, whereas public savings were to become positive, equivalent to 2.5 per cent of GDP. In 1981 the budget also provided for a levelling off of current expenditure (subsidies and transfers were budgeted to decline slightly) and a modest acceleration of capital expenditure, altering the composition of total expenditure in favor of capital expenditure (Tables 11, 12 and 14).

The official estimates for the 1981 fiscal outturn indicate that the overall budget objectives, as in 1980, were rather ambitious. The existing constraints in reducing current expenditure, the full wage indexation mechanism for wages and salaries, and the prevailing system of grain subsidies in particular, limited considerably the government efforts to reduce current expenditure; in consequence, capital expenditure had to be curtailed by more. In particular, whereas both domestic revenue and total expenditure fell short of their budgeted targets, domestic revenue increased by 19.6 per cent, raising the ratio of domestic revenue to GDP by 1 percentage point to 22.4 per cent. In contrast, total expenditure increased by an estimated 17.7 per cent, much less than in 1980, but

^{1/} These tax-relief measures, aimed at reducing the tax burden, which, in the authorities' view, during the last few years had risen beyond desirable levels, entailed a loss of public revenue estimated at £C 8.5 million on the basis of 1980 incomes. The tax measures, apart from increasing substantially the family and dependent allowances, increased also the tax exemptions on interest income from government securities and bank deposits (i.e., indirect interest rate subsidy). In addition, fiscal incentives were provided for increased capital expenditures by public companies, as well as additional tax exemptions for acquisitions of shares of newly established public companies.

still exceeding by far the 2.0 per cent growth allowed in the budget; as a result, the ratio of total expenditure to GDP increased by almost 1 percentage point, to 31.6 per cent. In consequence, the budget deficit ratio to GDP (excluding grants) is expected to remain at almost the same level as in 1980, at 9.2 per cent; because of a modest reduction in grants, the ratio of the overall budget deficit to GDP is projected to increase marginally to 7.8 per cent. Public savings continued to be negative, reaching 2.9 per cent of GDP during 1981.

Despite the overrun of total expenditure relative to the budgeted target, the growth of total expenditure decelerated substantially, increasing by only 17.7 per cent, compared to 31.6 per cent in 1980 and the 25.1 per cent average growth rate in the previous two years. Current expenditure, which accounts exclusively for the expenditure overrun increased by an estimated 22.5 per cent, down from the 35.6 per cent growth in 1980, raising the share of current expenditure in total expenditure to 80 per cent from 76.9 per cent in 1980. Both wages and salaries and transfers and subsidies, the main reasons for the expansion of current expenditure, decelerated relative to 1980, increasing by 19.6 per cent and 34.0 per cent, respectively; expenditure on goods and services grew moderately at 12.6 per cent, whereas unallocable expenditure remained at the same level as in 1980. The share of wages and salaries in total current expenditure declined by 10 percentage points to an estimated 40 per cent, while the share of subsidies and transfers rose by 3 1/2 percentage points to 40.9 per cent. The expansion of subsidies and transfers reflects the 35.3 per cent increase in grain and vine subsidies, the 48.6 per cent increase in interest payments on the expanding foreign and domestic public debt (Table 15), and the 41.9 per cent increase in social insurance benefits on account of the higher benefits provided by the new earnings-related social insurance scheme (Table 18). The ordinary budget expenditure increased by an estimated 22.9 per cent, providing the main impetus for the expansion of total current expenditure; apart from subsidies and interest payments, the increase of ordinary budget expenditure involved higher expenditure on education and defense (Table 15).

Development budget expenditure increased by only 10.0 per cent, continuing its decelerating trend, down from 13.2 per cent in 1980 and 45.6 per cent in 1979; the increase reflected mainly the 40.3 per cent expansion of the expenditure on transport and communication (Table 15). Expenditure by the Special Relief Fund followed a similar trend; capital expenditure on the refugee housing scheme increased by 6.7 per cent, compared to 14.4 per cent in 1980, accounting still for more than half of total capital expenditure (Table 19). As a result, capital expenditure fell short of its modest budget target, decelerating to 6.3 per cent relative to 11.8 per cent in 1980 and 38.8 per cent in 1979 (Tables 11, 12 and 14).

Domestic revenue did not reach its budget target, increasing by 19.6 per cent relative to 30.5 per cent in 1980. The rate of increase of tax revenue decelerated to 22.2 per cent from 27.9 per cent in the previous year, however, as a ratio to GDP, tax revenue increased by more than 1 percentage point to 18.5 per cent. The improvement in the tax

ratio is due entirely to the expansion of direct taxes, which, mainly because of the required higher social insurance contributions, increased by 39.1 per cent. Because of the sluggish growth of the indirect tax revenue of the ordinary budget, total indirect taxes slowed down to 7.7 per cent, less than half their growth rate in 1980 (Tables 12, 14, and 16). The ordinary budget revenue continued its decelerating trend, increasing by only 7.9 per cent as against 22.5 per cent in 1980, reflecting the slowdown of both its tax and nontax components (Table 16). As a result of the tax-relief measures of early 1981, the growth of the direct ordinary budget revenue decelerated to 14.8 per cent, from 25.7 per cent in 1980. While income taxes paid by companies increased by 46.7 per cent, more than five times higher than their growth rate in 1980, income taxes paid by individuals declined by 4.1 per cent, in contrast to their 42.0 per cent increase in the previous year. Indirect ordinary revenue slowed down as well, increasing by only 5.8 per cent, relative to 12.0 per cent in 1980 and 27.6 per cent in 1979. This deceleration is due to the reduction in the imports of motor vehicles, which resulted in the leveling off of the revenue from selective excises, and to the general decline in real imports (see Chapter IV), which allowed only a modest increase in import duties of 9.4 per cent.

Because 1981 is the first full year of operation of the new earnings-related social insurance scheme, the revenue of the Social Insurance Funds more than doubled relative to their high 1980 level, giving rise to an estimated £C 11.3 million surplus, in contrast to the traditional modest deficit; as expected, higher benefit payments were more than offset by the required higher contributions (Tables 13 and 18). Following the more than doubling of the revenues of the Special Relief Fund in 1980, because of the final payment of the delayed mandatory contributions by employers and the self-employed, in 1981 the revenue of the Special Relief Fund declined modestly by 5.5 per cent, returning to normal (Tables 13 and 19); reflecting the depressed demand for imports, the receipts of the temporary import levy slowed down to 25.0 per cent relative to 77.8 per cent in 1980.

The overall budget deficit in 1980 increased by 17.0 per cent to £C 66.8 million, raising marginally its ratio to GDP to 7.8 per cent (Table 20). Since the Central bank financing of the budget deficit was close to its legal limit, net domestic borrowing covered roughly the same proportion of the overall deficit as in 1980 (46.3 per cent). Central bank advances declined from £C 12.0 million in 1980 to £C 4.4 million in 1981, while the net issue of Treasury bills fell from £C 31.5 million in 1980 to £C 26.0 million in 1981; the issue of government securities to the nonbank public remained at £C 4.5 million, the same level as in the previous two years. As a consequence, net foreign borrowing increased both in absolute and relative terms. Net foreign borrowing expanded by 36.7 per cent to £C 42.5 million, covering 63.6 per cent of the deficit compared to 54.5 per cent in 1980, increasing the ratio of net foreign borrowing to GDP from 4.1 per cent in 1980 to 4.9 per cent in 1981. Net transactions with the IMF are negative, as a result of outstanding repurchase obligations. The expansion of domestic and foreign borrowing

increased the outstanding central government debt, as a ratio to GDP, by more than 5 percentage points to 32.4 per cent; similarly, debt service payments continued their upward trend increasing from 2.3 per cent of GDP in 1980 to 3.1 per cent in 1981 (Table 21 and Chart 3).

Table 11. Cyprus: Selective Fiscal Indicators, 1976-81

	1976	1977	1978	1979	1980	1981	
	Outturn					Budget <u>1/</u>	Estimated outturn
<u>(In per cent of GDP)</u>							
Revenue	19.3	19.5	19.6	19.6	21.4	23.4	22.4
Current revenue	19.3	19.5	19.6	19.6	21.4	23.4	22.4
Tax	14.1	15.0	15.5	16.1	17.3	19.8	18.5
Direct	6.6	6.0	6.2	6.5	8.0	10.2	9.7
Direct taxes on income and profits	2.1	2.3	2.9	3.3	3.6	3.9	3.4
Indirect	7.5	9.0	9.3	9.6	9.3	9.6	8.8
Nontax	5.2	4.6	4.1	3.4	4.1	3.6	3.9
Expenditure	31.0	27.0	26.8	27.1	29.5	26.7	30.8
Current expenditure	25.1	21.8	21.0	20.8	23.6	20.9	25.3
Wages and salaries	9.3	8.5	8.4	9.3	9.7	10.1	10.1
Subsidies and transfers	9.6	9.0	7.1	7.2	8.8	7.6	10.3
Capital expenditure	5.9	5.3	5.6	6.3	5.9	5.8	5.5
Total expenditure <u>2/</u>	32.0	27.9	28.0	27.9	30.7	27.4	31.6
Current savings	-5.8	-2.3	-1.4	-1.2	-2.2	2.5	-2.9
Budget balance excluding grants	-12.6	-8.4	-8.4	-8.3	-9.3	-3.9	-9.2
Foreign grants	4.5	5.6	2.7	2.1	1.7	1.5	1.4
Overall balance	-8.1	-2.8	-5.7	-6.2	-7.6	-2.4	-7.8
Non bank financing	--	2.0	1.1	1.2	0.6	..	0.5
Bank financing	0.3	-3.0	3.6	2.8	2.9	...	2.7
Net foreign borrowing	2.9	3.7	2.5	1.7	4.1	...	4.9
<u>(In per cent)</u>							
Share of current expenditure in total expenditure	78.6	77.9	74.9	74.6	76.9	76.2	80.0
Share of wages and salaries in total current expenditure	37.2	39.2	40.2	44.6	50.0	48.4	40.0
Share of subsidies and transfers in total current expenditure	38.0	41.2	34.1	34.7	37.4	36.6	40.9
Share of capital expenditure in total expenditure	18.4	18.8	20.1	22.7	19.3	21.4	17.4
Share of housing expenditure by the Special Relief Fund in total capital expenditure	58.3	62.6	60.1	52.6	53.8	50.6	54.0
Share of tax revenue in total domestic revenue	73.1	76.7	79.1	82.4	80.7	84.7	82.4
Share of direct taxes in total tax revenue	46.9	39.9	40.2	40.5	46.1	51.3	52.5
Share of indirect taxes in total tax revenue	53.1	60.0	59.8	59.5	53.9	48.7	47.5

Source: Data provided by the Cypriot authorities.

1/ As amended by the tax measures introduced in early 1981.

2/ Expenditure plus net lending.

Table 12. Consolidated Central Government Budget, 1/ 1976-81

(In millions of Cyprus pounds)

	1976	1977	1978	1979	1980	1981	
	Outturn					Budget ^{2/}	Estimated outturn
1. Revenue	63.3	82.4	99.7	123.2	160.8	201.2	192.4
Current revenue	63.2	82.3	99.5	123.0	160.7	201.0	192.2
Tax	46.3	63.2	78.9	101.5	129.8	170.4	158.6
Direct ^{3/}	21.7	25.2	31.7	41.1	59.8	87.5	83.2
Indirect ^{4/}	24.6	37.9	47.2	60.4	70.0	82.9	75.4
Nontax	16.9	19.2	20.6	21.5	30.9	30.6	33.6
Capital revenue	0.1	0.1	0.2	0.2	0.1	0.2	0.2
2. Expenditure	101.5	114.0	135.2	170.4	221.6	229.3	264.2
Current expenditure	82.3	91.8	106.6	130.7	177.2	179.1	217.0
Wages and salaries	30.6	36.0	42.9	58.3	72.6	86.6	86.8
Goods and services	17.5	18.2	20.8	24.0	25.3	26.7	28.5
Subsidies and transfers	31.3	37.8	36.3	45.4	66.2	65.6	88.7
Unallocable ^{5/}	2.9	-0.2	6.6	3.0	13.1	--	13.0
Capital expenditure	19.2	22.2	28.6	39.7	44.4	50.2	47.2
Investment	16.1	16.9	20.9	30.9	34.4	38.7	37.7
Transfers	3.1	5.3	7.7	8.8	10.0	11.5	9.5
3. Net lending	3.2	3.9	7.2	4.7	8.8	5.6	7.0
4. Budget balance excluding foreign grants (1-2-3)	-41.4	-35.5	-42.7	-51.9	-69.6	-33.7	-78.8
5. Foreign grants	14.8	23.7	13.7	13.1	12.5	13.1	12.0
6. Overall balance (4+5)	-26.6	-11.8	-29.0	-38.8	-57.1	-20.6	-66.8
<u>Memorandum items:</u>							
Current savings (in millions of Cyprus pounds)	-19.1	-9.5	-7.1	-7.7	-16.5	21.1	-24.8
Total expenditure (in per cent of GDP)	32.0	27.9	28.0	27.9	30.7	27.4	31.6
Domestic revenue (in per cent of GDP)	19.3	19.5	19.6	19.6	21.4	23.4	22.4
Budget balance excluding grants (in per cent of GDP)	-12.6	-8.4	-8.4	-8.3	-9.3	-3.9	-9.2
Overall balance (in per cent of GDP)	-8.1	-2.8	-5.7	-6.2	-7.6	-2.4	-7.8

Source: Data provided by the Cypriot authorities.

1/ For definition of Central Government, see Chapter II, Section 1. For details of the consolidation, See Table 13

2/ As amended by tax measures introduced in early 1981.

3/ Includes direct taxes in the ordinary budget (Table 16), social security contributions (Table 18), and the mandatory contributions to the Relief Fund (Table 19).

4/ Includes indirect taxes in the ordinary budget (Table 16), and the temporary import levy for the Special Relief Fund (Table 19)

5/ This item used to be below the line as part of changes in advances in Table 20. It comprises mainly of transfers to semi-public organizations and other expenditures, believed to constitute largely current expenditure.

Table 13. Cyprus: Consolidated Central Government Budget, 1976-81

(In millions of Cyprus pounds)

	1976	1977	1978	1979	1980	1981	
	Outturn					Budget ^{1/}	Estimated outturn
1. Revenue ^{2/}	63.3	82.4	99.7	123.2	160.8	201.2	192.4
Ordinary budget	48.3	66.2	81.4	102.1	125.1	149.0	135.0
Public Loans Funds	0.6	0.7	0.9	0.9	0.9	0.9	0.9
Social Insurance Funds	5.7	7.2	10.4	12.6	18.0	36.1	40.3
Special Relief Fund	7.9	8.0	6.6	7.1	16.3	14.4	15.4
Sinking Funds ^{3/}	0.8	0.3	0.4	0.5	0.7	0.8	0.8
2. Expenditure ^{4/}	101.5	114.0	135.2	170.4	221.6	229.2	264.2
Ordinary budget	57.9	68.7	75.7	99.5	128.4	132.9	157.8
Development budget	12.7	13.8	18.2	26.5	30.0	37.8	33.0
Public Loans Fund	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Social Insurance Fund	8.1	10.0	12.8	15.2	20.5	27.2	29.0
Special Relief Fund	19.8	21.6	21.8	26.1	29.5	31.3	31.3
Unallocable	2.9	-0.2	6.6	3.0	13.1	--	13.0
3. Net lending ^{5/}	3.2	3.9	7.2	4.7	8.8	5.6	7.0
Public Loans Fund	2.9	1.7	2.6	1.5	2.0	2.0	2.0
Social Insurance Funds	--	--	0.2	--	--	--	2.0
Special Relief Fund	0.3	0.9	1.4	1.5	3.7	2.6	2.0
Advances	--	1.3	3.0	1.0	3.1	1.0	1.0
Development Fund	--	--	--	0.7	--	--	--
4. Budget balance, excluding foreign grants (1-2-3)	-41.4	-35.5	-42.7	-51.9	-69.6	-33.7	-78.8
5. Foreign grants ^{6/}	14.8	23.7	13.7	13.1	12.5	13.1	12.0
Budgetary grants	11.5	12.1	9.9	8.2	8.1	10.1	10.0
Special Relief Fund	3.3	11.6	3.8	4.9	4.4	3.0	2.0
UN	2.3	11.1	3.5	4.7	4.2	2.8	1.8
Other	1.0	0.5	0.3	0.2	0.2	0.2	0.2
6. Overall balance (4+5)	-26.6	-11.8	-29.0	-38.8	-57.1	-20.6	-66.8

Source: Data provided by the Cypriot authorities.

^{1/} As amended by tax measures introduced in early 1981.

^{2/} Equals the sum of total ordinary budget revenue from Table 16, interest from Table 17, employers' and employees' contributions and interest from Table 18, and mandatory and voluntary local contributions, receipts from the temporary import levy, sales of goods and other domestic receipts from Table 19.

^{3/} Interest income from the Sinking Funds Account.

^{4/} Equals the sum of expenditure as stated in Tables 15, 17, 18 and 19.

^{5/} Equals the sum of net lending from Tables 17, 18, and 19, plus advances to semi-public organizations and net lending by the Development Fund.

^{6/} Equals the sum of foreign grants from Table 16 and contributions from abroad and reimbursements from Table 19.

Table 14. Cyprus: Consolidated Central
Government Budget, 1976-81

(Percentage changes)

	1977	1978	1979	1980	1981	
	Outturn				Budget ^{1/}	Estimated Outturn
1. Revenue	30.2	21.0	23.6	30.5	25.1	19.6
Current revenue	30.2	20.9	23.6	30.6	25.1	19.6
Tax	36.5	24.8	28.6	27.9	31.3	22.2
Direct	16.1	25.8	29.7	45.5	46.3	39.1
Indirect	54.0	24.5	28.0	15.9	18.4	7.7
Nontax	13.6	7.3	4.4	43.7	-1.0	8.7
2. Expenditure	12.3	18.6	26.0	30.0	3.5	19.2
Current expenditure	11.5	16.1	22.6	35.6	1.1	22.5
Wages and salaries	17.6	19.2	35.9	24.5	19.3	19.6
Goods and services	4.0	14.3	15.4	5.4	5.5	12.6
Subsidies and transfers	20.8	-4.0	25.1	45.8	-0.9	34.0
Capital expenditure	15.6	28.8	38.8	11.8	13.1	6.3
3. Net lending	21.9	84.6	-34.7	87.2	-36.4	-20.5
4. Total expenditure (2+3)	12.6	20.8	23.0	31.6	2.0	17.7
5. Budget balance excluding grants (1-4)	-14.3	20.3	21.5	34.1	-51.6	13.2
6. Foreign grants	60.1	-42.9	-4.4	-4.6	4.8	-4.0
7. Overall balance (5+6)	-55.6	145.8	33.8	47.2	-63.9	17.0
Memorandum items:						
Percentage changes of revenue and expenditure of individual budgets						
Revenue	30.2	21.0	23.6	30.5	25.1	19.6
Ordinary budget	37.1	23.0	25.1	22.5	19.1	7.9
Social Insurance Funds	23.6	44.4	21.2	42.9	100.6	123.9
Special Relief Fund	1.3	-17.5	7.6	129.6	-11.7	-5.5
Expenditure	12.3	18.6	26.0	30.0	3.5	19.2
Ordinary budget	18.7	10.2	31.4	29.0	3.5	22.9
Development budget	8.7	31.9	45.6	13.2	26.0	10.0
Social Insurance Funds	23.5	28.0	18.7	34.9	32.7	41.5
Special Relief Fund	9.1	0.9	19.7	13.0	6.1	6.1

Source: Data provided by the Cypriot authorities.

^{1/} As amended by the tax measures introduced in early 1981.

Table 15. Cyprus: Government Budget Expenditure, 1976-81

(In millions of Cyprus pounds)

	1976	1977	1978	1979	1980	1981	
	Outturn					Budget ^{1/}	Estimated outturn
Ordinary budget expenditure ^{2/}	58.0	68.7	75.7	99.5	128.4	132.9	157.8
General public services	18.0	18.9	22.4	28.4	37.6	40.5	39.8
Of which:							
Public order and safety	8.9	9.6	10.5	13.7	16.7	19.4	19.3
Defense	7.9	10.4	8.9	12.7	10.9	11.4	17.7
Education	9.1	12.8	14.9	18.1	22.3	25.3	27.7
Health	5.2	5.8	7.0	9.0	11.9	12.6	11.0
Welfare and social services	4.7	5.6	6.7	7.9	10.1	11.9	10.8
Economic sectors	3.6	4.3	5.0	5.4	6.1	8.4	8.2
Of which:							
Agriculture	1.5	1.9	2.7	1.7	2.0	2.2	2.2
Subsidies	5.0	5.0	3.0	7.0	15.3	10.0	20.7
Interest on public debt ^{3/}	4.1	6.4	7.4	10.7	14.4	11.0	21.4
Miscellaneous	0.2	0.3	0.3	0.3	0.3	1.8	0.5
Development budget expenditure ^{4/}	12.7	13.8	18.2	26.5	30.0	37.8	33.0
Social sectors	2.6	3.0	3.5	4.6	6.7	8.5	7.5
Of which:							
Housing	1.0	0.8	1.0	1.6	3.2	2.1	2.0
Economic sectors	9.9	10.7	14.7	21.8	23.2	29.2	25.4
Of which:							
Agriculture	4.8	5.8	8.5	12.7	12.9	13.9	11.5
Transport and communication	3.1	2.8	3.3	6.1	7.1	11.6	10.0
Tourism	0.3	0.5	0.5	0.6	0.6	1.0	1.0
Commerce and industry	0.4	0.9	1.5	1.5	1.4	1.3	1.7
Other	1.3	0.7	0.9	0.9	1.2	1.4	1.2
Other	0.2	0.1	0.1	0.1	0.1	0.1	0.1
Total ordinary and development budgets expenditure ^{5/}	71.1	82.8	94.4	126.5	158.4	170.6	190.8
Current expenditure	63.1	74.5	82.2	106.9	137.9	145.7	168.1
Wages and salaries	30.1	34.8	42.0	55.9	70.5	84.3	84.2
Goods and services	14.6	15.4	19.9	23.1	24.1	25.4	27.3
Subsidies and transfers	18.4	24.3	20.3	27.9	43.3	36.0	57.6
Capital expenditure	8.0	8.3	12.2	19.6	20.5	24.9	21.7
Investment	7.2	7.3	11.0	17.4	17.2	21.0	18.5
Transfers	0.8	1.0	1.2	2.2	3.3	3.9	3.2

Source: Data provided by the Cypriot authorities.

^{1/} As amended by tax measures introduced in early 1981.

^{2/} Excludes transfers to Development Fund, Post Office expenditures, refunds and draw-backs, contributions and transfers to Social Security Funds, Public Loans Fund, and Relief Fund for Displaced Persons.

^{3/} Including interest payments on IMF credit.

^{4/} Excludes transfers to Public Loans Fund and Relief Fund for Displaced Persons.

^{5/} Excludes intergovernmental transfers and Post Office expenditure.

Table 16. Cyprus: Government Ordinary Budget
Revenue and Grants, 1976-81

(In millions of Cyprus pounds)

	1976	1977	1978	1979	1980	1981	
	Outturn					Budget ^{1/}	Estimated outturn
Direct taxes	9.7	14.1	19.2	26.8	33.7	46.9	38.7
Taxes on net income and profits	6.8	9.7	14.5	20.5	26.9	33.2	29.5
Enterprises (companies only)	2.0	2.2	3.2	6.7	7.3	13.8	10.7
Individuals ^{2/}	4.8	7.5	11.3	13.8	19.6	14.6	18.8
Taxes on property	0.7	1.3	1.7	2.1	2.5	8.4	4.2
Other ^{3/}	2.2	3.1	3.0	4.2	4.3	5.3	5.0
Indirect taxes	24.7	35.8	44.5	56.8	63.6	75.8	67.3
Taxes on goods and services	11.2	13.7	21.1	31.1	32.9	37.0	33.4
Selective excises	9.5	11.9	18.8	28.5	29.7	33.6	29.5
Motor vehicle taxes (paid by businesses)	1.0	0.8	1.4	1.5	1.9	2.0	2.4
Licenses and taxes on services	0.7	1.0	0.9	1.1	1.3	1.4	1.5
Taxes on international trade and transactions	11.5	19.7	20.4	22.2	26.6	33.8	29.1
Of which:							
Import duties	11.5	19.7	20.4	22.2	26.6	33.8	29.1
Other ^{4/}	2.0	2.4	3.0	3.5	4.1	5.0	4.8
Nontax revenue	14.0	16.2	17.7	18.5	28.8	26.4	29.0
Sales of goods and services	4.6	4.8	5.4	5.8	7.8	8.2	8.8
Interest, dividends, rents and royalties	5.9	6.6	7.1	6.6	11.8	9.9	12.0
Of which:							
Central bank profits	4.0	4.0	4.0	3.4	7.5	6.0	7.1
Transfers	2.5	3.3	4.0	4.9	7.3	6.8	7.1
Of which:							
Lotteries	0.9	1.3	1.8	2.0	2.7	2.5	3.4
Miscellaneous	1.0	1.5	1.2	1.2	1.9	1.5	1.1
Total ordinary budget revenue	48.4	66.1	81.4	102.1	126.1	149.1	135.0
Foreign grants	11.5	12.1	9.9	8.2	8.1	10.1	8.6
Total ordinary budget revenue and grants	59.8	78.2	91.3	110.3	134.2	159.2	143.6

Source: Data provided by the Cypriot authorities.

^{1/} As amended by tax measures introduced in early 1981.

^{2/} Includes employees and self-employed.

^{3/} Includes registration and road licenses of motor vehicles and drivers' licenses used for noncommercial purposes.

^{4/} Includes stamp duty, registration of ships, airport landing, parking fees, shipping dues, and pilotage fees.

Table 17. Cyprus: Accounts of Public Loans Fund, 1976-81

(In millions of Cyprus pounds)

	1976	1977	1978	1979	1980	1981
	Outturn					Estimated Outturn
Revenue	<u>0.9</u> ^{1/}	<u>2.7</u>	<u>2.8</u>	<u>1.9</u>	<u>1.7</u>	<u>1.7</u>
Interest	<u>0.7</u>	<u>0.7</u>	<u>0.8</u>	<u>0.9</u>	<u>0.9</u>	<u>0.9</u>
Net borrowing from Government ^{2/}	0.1	2.0	2.0	1.0	0.8	0.8
Expenditure	<u>0.1</u>	<u>0.1</u>	<u>0.1</u>	<u>0.1</u>	<u>0.1</u>	<u>0.1</u>
Expenses	<u>0.1</u>	<u>0.1</u>	<u>0.1</u>	<u>0.1</u>	<u>0.1</u>	<u>0.1</u>
Net lending	<u>2.7</u>	<u>1.7</u>	<u>2.6</u>	<u>2.2</u>	<u>2.0</u>	<u>2.0</u>

Source: Data provided by the Cypriot authorities.

^{1/} Including official grants.

^{2/} Eliminated on consolidation.

Table 18. Cyprus: Accounts of Social Insurance Funds, ^{1/} 1976-81

(In millions of Cyprus pounds)

	1976	1977	1978	1979	1980	1981	
	Outturn					Budget	Estimated Outturn
Revenue	<u>8.9</u>	<u>12.2</u>	<u>16.1</u>	<u>18.7</u>	<u>30.1</u>	<u>53.1</u>	<u>59.8</u>
Employers' and self-employed contributions	3.7	4.8	7.1	7.7	10.7	21.8	22.8
Employees' contributions	1.5	1.7	2.5	3.7	5.9	11.8	14.7
Government's contributions as employer ^{3/}	0.8	0.9	1.0	1.2	2.7	6.6	7.7
Government contributions ^{3/}	2.4	4.1	4.7	4.9	9.4	10.4	11.8
Interest and other	0.5	0.7	0.8	1.2	1.4	2.5	2.8
Expenditure	<u>8.1</u>	<u>10.0</u>	<u>12.8</u>	<u>15.2</u>	<u>20.5</u>	<u>27.2</u>	<u>29.0</u>
Administrative expenses	0.4	0.5	0.6	0.6	0.7	0.8	0.9
Benefit payments	7.7	9.5	12.2	14.6	19.8	26.4	28.1
Net lending	--	--	<u>2.0</u>	--	--	--	<u>2.0</u>

Source. Data provided by the Cypriot authorities.

^{1/} Social Insurance Fund, Social Security Scheme, Central Holiday Fund, and Redundancy Fund.

^{2/} As amended by tax measures introduced in early 1981.

^{3/} Eliminated on consolidation.

Table 19. Cyprus: Accounts of Relief Fund
for Displaced Persons, 1976-81

(In millions of Cyprus pounds)

	1976	1977	1978	1979	1980	1981	
	Outturn					Budget ^{1/}	Estimated Outturn
Receipts	16.1	23.8	16.1	18.0	26.8	21.4	22.1
Taxes on income and profits	6.8	4.5	2.9	2.9	9.5	7.0	7.0
Temporary import levy	--	2.1	2.7	3.6	6.4	7.0	8.0
Other local contributions	0.6	0.4	0.1	0.1	0.1	0.1	0.1
Sales of goods	0.5	0.9	0.8	0.4	0.1	0.2	0.2
Government contributions ^{2/}	4.9	4.5	6.0	6.0	6.0	4.0	4.0
Reimbursements ^{3/}	2.3	10.8	3.2	4.7	4.4	2.9	2.5
Foreign contributions ^{3/}	1.0	0.5	0.3	0.2	0.1	0.1	0.2
Other ^{4/}	--	0.1	0.1	0.1	0.2	0.1	0.1
Expenditure	19.8	21.6	22.6	26.1	29.5	31.3	31.3
Current expenditure	8.6	7.7	5.4	5.2	5.6	5.9	5.8
Of which:							
Transfers	5.1	4.0	3.5	2.7	3.0	3.1	3.0
Capital expenditure	11.2	13.9	17.2	20.9	23.9	25.4	25.5
Of which:							
Transfers	2.3	4.3	6.5	7.1	6.7	6.3	6.3
Net lending	0.3	0.9	1.4	1.5	3.7	2.6	2.0

Source: Data provided by the Cypriot authorities.

^{1/} As amended by tax measures introduced in early 1981.

^{2/} Eliminated on consolidation.

^{3/} Foreign grants.

^{4/} Including rents and interest payments.

Table 20. Cyprus: Financing of Overall
Government Balance, 1/ 1976-81

(In millions of Cyprus pounds)

	1976	1977	1978	1979	1980	1981 Estimated outturn
	Outturn					
Financing need	26.6	11.8	29.0	38.8	57.1	66.8
Net domestic borrowing	15.6	-4.8	23.1	34.5	26.1	30.9
Local bond and stock issues	1.0	5.0	1.0	4.5	4.5	4.5
Treasury bills, net	20.0	-8.5	16.0	4.6	31.5	26.0
Local loan repayments 2/	-2.6	-0.8	-0.6	-0.5	-1.3	--
Change in deposits with Treasury	1.4	-0.4	0.6	3.8	1.3	-1.0
Net borrowing from private funds	-0.1	-0.1	0.1	-1.5	-1.0	--
Changes in advances from the Central Bank and from the Treasury	-4.1	--	6.0	23.6	-8.9	1.4
Use of cash balances						
increase (-)	-14.7	0.8	-0.7	-9.2	0.3	-3.5
Change in cash	-15.3	2.5	6.4	-2.9	14.4	-0.5
Change in investments	0.6	-1.7	-2.6	-3.3	-1.6	-3.0
Change in advances to the cooperative Central Bank	--	--	-2.1	-3.2	-12.5	--
Net foreign borrowing	9.6	15.8	12.9	11.0	31.1	42.5
Loan proceeds	10.1	16.2	13.4	12.1	35.0	49.0
Loan repayments	-0.5	-0.4	-0.5	-1.1	-3.9	-6.5
Net IMF transactions	16.1	--	-7.7	2.5	-0.4	-3.1
Receipts	16.1	--	--	4.7	6.3	--
Payments	--	--	-7.7	-2.2	-6.7	-3.1
Memorandum items:						
Net domestic financing	0.9	-4.0	23.8	25.3	26.4	27.4
Bank 3/	0.9	-12.5	18.1	17.9	22.0	22.9
Non-bank	--	8.5	5.7	7.4	4.4	4.5

Source: Data provided by the Cypriot authorities.

1/ Consolidated operations on ordinary and development budgets, Social Security Funds, Public Loans Fund, and Relief Fund for Displaced Persons, accounts.

2/ Includes contributions to sinking funds. Liquidation of sinking funds is not taken into account in this table.

3/ On the basis of government accounts; figures do not necessarily agree with the monetary survey.

Table 21. Cyprus: Outstanding Debt of Central Government, 1976-81

(In millions of Cyprus pounds; end of period)

	1976	1977	1978	1979	1980	1981 ^{1/}
Foreign debt ^{2/}	<u>21.8</u>	<u>38.1</u>	<u>52.2</u>	<u>62.8</u>	<u>94.9</u>	<u>137.4</u>
Governments	3.9	5.3	6.0	6.4	6.0	6.0
Development agencies	17.9	21.0	26.1	29.0	36.3	46.3
Banks	--	11.8	20.1	27.4	52.6	85.1
Domestic debt	<u>52.1</u>	<u>47.9</u>	<u>64.4</u>	<u>73.5</u>	<u>110.0</u>	<u>140.7</u>
Long-term ^{3/}	7.5	11.8	12.3	16.8	21.8	26.5
Short-term (Treasury bills) ^{4/}	44.6	36.1	52.1	56.7	88.2	114.2
Total debt outstanding	<u>74.0</u>	<u>86.0</u>	<u>116.6</u>	<u>136.3</u>	<u>204.9</u>	<u>278.1</u>

Source: Data provided by the Cypriot authorities.

^{1/} Estimates.

^{2/} Excludes foreign contractors' credits and borrowing from the IMF.

^{3/} Held mainly by provident funds, insurance companies, and private individuals.

^{4/} Held mainly by banks.

)

III. Money and Credit

1. Overview and policy developments

Developments in money and credit up to mid-1980 broadly reflect the expansionary stance of policy that the authorities had adopted to promote recovery from the hostilities of 1974. Given the rapid pace of recovery with real GDP growing at 19 per cent in 1977, 8 1/2 per cent in 1978, 7 per cent in 1979, and given the narrowing of the gap between potential and actual output growth, inflation accelerated and the deficit in the current account of the balance of payments increased. The selective measures adopted in 1978 to reduce the pace of recovery and improve internal and external balance did not succeed. On the contrary, expansion in total domestic credit and total liquidity accelerated further. ^{1/} Rates of growth in domestic credit over the preceding 12 months amounted to 20 per cent in 1977, 24 per cent in 1978, 26 per cent in 1979, and 32 1/2 per cent in the first quarter of 1980. Total liquidity grew at corresponding rates of 14 1/2 per cent in 1977, 15 per cent in 1978, 18 1/2 per cent in 1979, and 19 per cent in the first quarter of 1980. In the second quarter of the same year, domestic credit recorded its largest expansion at 34 per cent, while expansion in total liquidity declined to some 14 1/2 per cent owing to the worsening drain on international reserves. As a result of these developments and the accompanying expansionary fiscal stance described in Chapter II, the deficit on the current account of the balance of payments rose from £C 36 million in 1977 to £C 59 million in 1978, to £C 73 million in 1979 and to £C 118 million at an annual rate in the first half of 1980, equivalent to 16 per cent of GDP. With the output gap closed by the beginning of 1979 and with output growing above capacity since then, the rapid monetary expansion lifted the rate of inflation into the double digits for the first time in 1979.

Faced with this deterioration in the economy the authorities set out a policy of restraint in the Third Emergency Economic Action Plan for the years 1979-81, but the implementation of restrictive measures was delayed to 1980. Credit ceilings began to be adopted in March, and a stabilization program with the Fund entered into force for the year from the beginning of July 1980 to the end of June 1981. Under the measures announced in March, banks were allowed to expand credit to the private sector in 1980 either up to 12 per cent of their total advances, loans and local bills discounted outstanding at the end of December 1979 or up to 8 per cent over corresponding totals at the end of February 1980, whichever the banks preferred. Later, in August, these ceilings were extended to cover the program period to June 1981: credit to the private sector was allowed to expand by 20.5 per cent from end-December 1979

^{1/} The measures included restrictions on personal loans, loans to automobile importers, and loans to finance companies; hire-purchase regulations were tightened. While this led to reduced credit expansion to the private sector, the rise in public sector credit more than compensated for it and total domestic credit expansion accelerated.

levels or by 14.5 per cent from end-June 1980 levels, equivalent in this latter instance to £C 56 million. In a move to increase supply and restore a more sustainable composition of absorption, the authorities exempted from the ceilings projects aimed at productive investment, to be financed by the Fund for Priority Projects (FPP). This Fund, operated by the Central Bank, is financed by contributions from the banks in the amount of 6 per cent of their deposits subject to the "minimum liquidity requirement." In the past, the Central Bank has provided the banks with short-term credit, helping them finance their contributions, or, put differently, maintain their "minimum liquidity requirements." Credit outstanding from the FPP has increased over the years from £C 5.8 million at end of 1978 to £C 8.9 million in 1979, then further to £C 13.7 million in 1980 and £C 17 million at the end of August 1981.

The Fund program proper involved restrictions of a more general nature. The authorities imposed a target of £C 72 million, equivalent to 16 per cent of the stock of broad money then estimated for the end of June 1980, on the expansion of total domestic credit over the program year. The share of the private sector, including priority projects, was limited to £C 62 million or 86 per cent of total, that of the public sector to £C 10 million or 14 per cent. The authorities hoped that imposing credit ceilings and exercising fiscal restraint would reduce monetary expansion. From an average annual rate of growth of some 17 per cent in 1979 and the first half of 1980, the expansion of broad money was to be reduced to 12 per cent in the program year. At the same time they held that official foreign exchange holdings, which amounted to less than two months of merchandise imports at an annual rate in the first half of 1980, would be restored to at least double that amount. Further, according to the Third Emergency Economic Action Plan, it was expected that real GDP would grow at a rate between 3 per cent and 4 per cent in 1981, while the rate of inflation would be down to about 10 per cent per annum.

Actual developments in the economy since the middle of 1980 have generally vindicated the authorities' stabilization policy, the most important exception being the failure to constrain the budget deficit and credit to the public sector. At the end of June 1981, the year-on-year increase in total net domestic credit amounted to £C 73 million, barely in excess of the ceiling. In fact, credit expansion to the private sector remained at £C 49 million, substantially below its target of £C 62 million. By contrast, credit expansion to the public sector amounted to £C 24 million, far in excess of its £C 10 million target. Hence, the overall target was only met because of compensating deviations from the individual private and public sector targets. Of importance in the monetary area is also the successful restoration of official foreign exchange holdings to a level equivalent to four months' merchandise imports by the end of August 1981. It remains to point out that realization of the overall credit and foreign exchange objectives is inconsistent with any slowdown of growth in broad money. Instead, it is the actual rise in broad money of some 19 per cent over the program year that may be considered in keeping with those objectives. During the program period inflation has decelerated to a rate near

10 per cent by mid-1980. The authorities are aware, however, that if inflation is to remain in the single-digit range over the medium term, monetary growth has to be reduced from the current level.

In June 1981 banks were informed that prevailing economic conditions necessitated the continuation of a restrictive monetary policy for the whole of 1981. Accordingly, credit ceilings were extended from end-June 1981 to end-December 1981 and the overall ceiling in credit expansion to the private sector was put at £C 26 million. Ceilings were made more restrictive and, at the same time, more selective. Loans to the trading sector--except for exports--were to remain at their end-June level for the rest of the year; banks were asked to reclassify their trade loans to show export loans separately. Similarly, personal and professional loans were to remain at their end-June level. Local bills discounted, falling within these categories of loans, must equally remain at end-June levels. On the other hand, loans for priority projects were exempted from the ceilings. Unused allocations under the credit ceilings for the program year, net of any excesses over those ceilings, were allowed to be carried over to the remainder of 1981. This was done to avoid a situation where banks would have made strenuous attempts--on announcement of the extension of restrictive credit policy in June--to make loans.

2. Developments in monetary aggregates

In the period from 1979 to the end of the third quarter of 1981, total liquidity grew rapidly at year-on-year rates of 18 1/2 per cent by the end of 1979, some 16 per cent a year later and around 20 per cent by the end of September 1981. As for the components of total liquidity, the divergent developments in narrow money and quasi-money, already in evidence since 1978 (Tables 20 and 21 and Charts 4 and 5), generally continued: narrow money grew more rapidly than quasi-money. The size of the divergence, however, which had increased to almost 15 percentage points by the end of the first quarter of 1980, when narrow money and quasi-money increased at respective year-on-year rates of 29.5 per cent and 14.7 per cent, subsequently declined to between 1-3 percentage points in the first two quarters of 1981. Finally, in the third quarter, quasi-money grew faster than narrow money. Looked at individually, narrow money shows a decline in growth of 7 percentage points over the period attributable largely to reduced expansion in demand deposits while cash holdings were relatively less affected. In contrast, quasi-money registered a rise of 5 percentage points in its rate of expansion as a result, in particular, of an accelerating build-up of time deposits in the second and third quarters of 1981. Accordingly, with the weight of quasi-money in total liquidity being larger than that of narrow money, rapid growth in total liquidity persisted.

Among the factors accounting for these divergences and the changes in them are movements in the real interest rates on time deposits and the relative effect of changes in net foreign assets on the two money aggregates. Real interest rates, which had become negative once more in 1977, continued

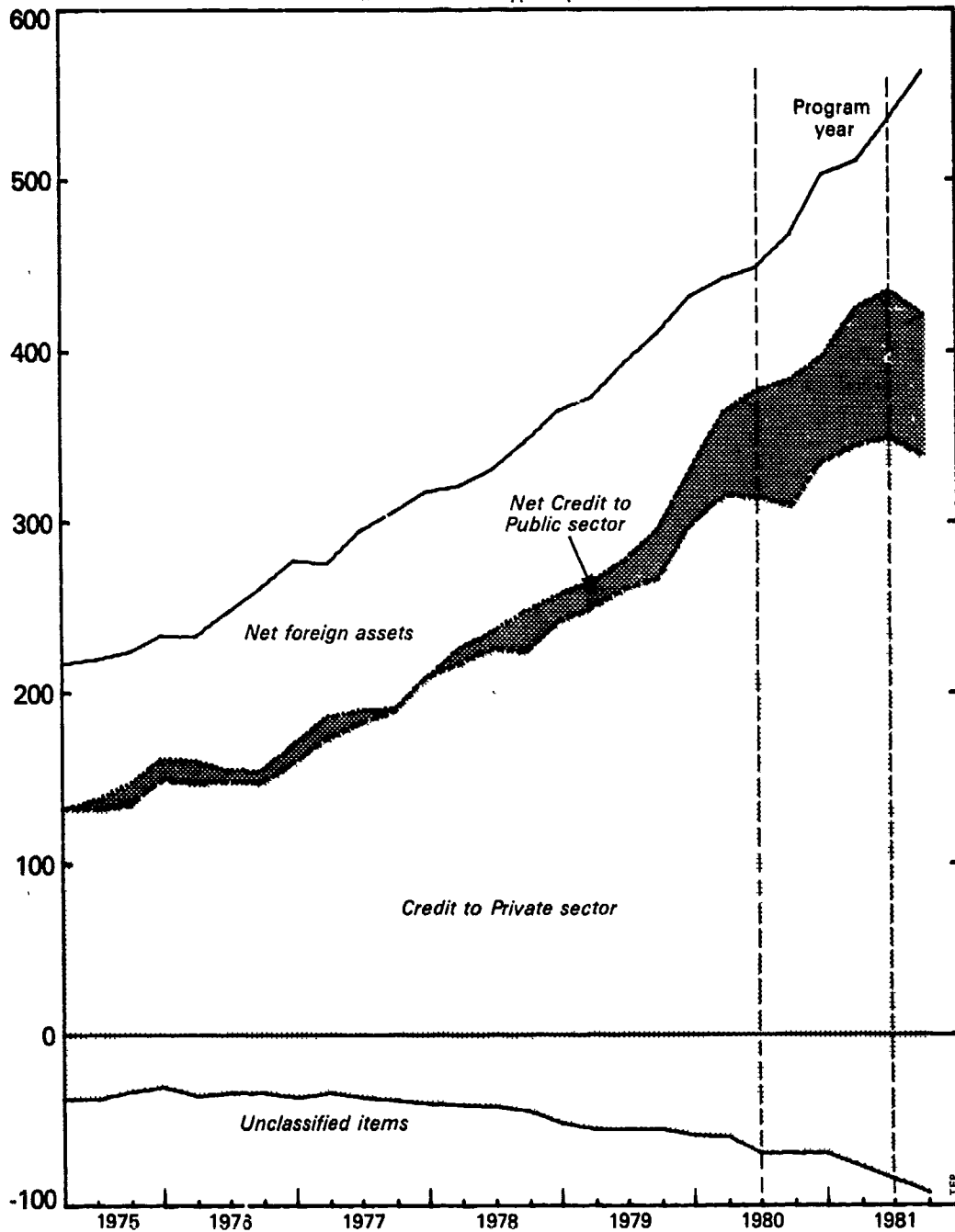
to fall until the first half of 1980--encouraging a switch out of money and into both higher interest-bearing deposits with cooperative banks which are not counted in the monetary survey and real assets. Since then, real interest rates recovered somewhat as a result of decelerating inflation. Over the five years from 1976 to 1980 velocity increased but, except for 1980, at a declining rate (Chart 6). In 1981 velocity is expected to fall. These movements in velocity have affected developments in inflation. The upward drift in velocity has contributed to the acceleration of inflation up to mid-1980, while the decline in velocity will have contributed to the subsequent deceleration of inflation. This stresses the need for further efforts to reduce growth in money over the medium term when velocity cannot be assumed to continue its decline, thereby helping to keep inflation down. It appears further that unless interest rates are adjusted, or more generally, are allowed to respond to economic factors, negative real interest rates may give rise to an upward drift in velocity and a consequent inflationary bias.

Domestic credit to the private sector, which in 1978 had temporarily grown more slowly than the year earlier on account of the selective measures of credit restraint adopted in mid-year, grew again at increasing rates in 1979 and the first quarter of 1980, on a year-on-year basis. From the 18 per cent mark in 1978 its growth accelerated to 21.8 per cent in 1979 and 23.1 per cent in the first quarter of 1980. From the second quarter of 1980 on, however, the reverse applies. Domestic credit to the private sector exhibits a virtually continuously declining rate of expansion to mid-1981. Decelerating by about 1 1/2 percentage points, credit expanded by 21.5 per cent in the second quarter of 1980. In the subsequent two quarters the deceleration gathered momentum involving a 4 percentage point reduction both in the third and fourth quarters to rates of expansion of 17.6 per cent and 13.5 per cent, respectively. During the following two quarters of 1981 corresponding rates of 12.8 per cent were recorded in each instance, although in the third quarter credit expansion did turn up somewhat. Under the influence of both a cyclical weakening of demand for credit and the restrictive measures adopted in March, the decline in domestic credit expansion is thus seen to have begun ahead of the implementation of the stabilization program with the Fund, to have responded most strongly to it during its first half and to have shown its full response by the end of the second half.

The banking system's claims on the public sector followed a different pattern. In terms of year-on-year increases in absolute values, these claims stood at £C 16.2 million at the end of 1979, £C 33.5 million in the first quarter of 1980, £C 45.7 million in the second quarter, and £C 46.2 million in the third quarter. This tendency of increasing public sector domestic borrowing was reversed in the fourth quarter of 1980 when the year-on-year increase declined to £C 30 million; in the first quarter of 1981 the increase was on the same order, amounting to £C 31 million. A further easing of claims on the public sector was registered in the second quarter of 1981, with the increase down to £C 23.8 million, followed by a sharp fall to £C 8.3 million in the third quarter. However, developments in domestic credit to the public sector must be seen in the

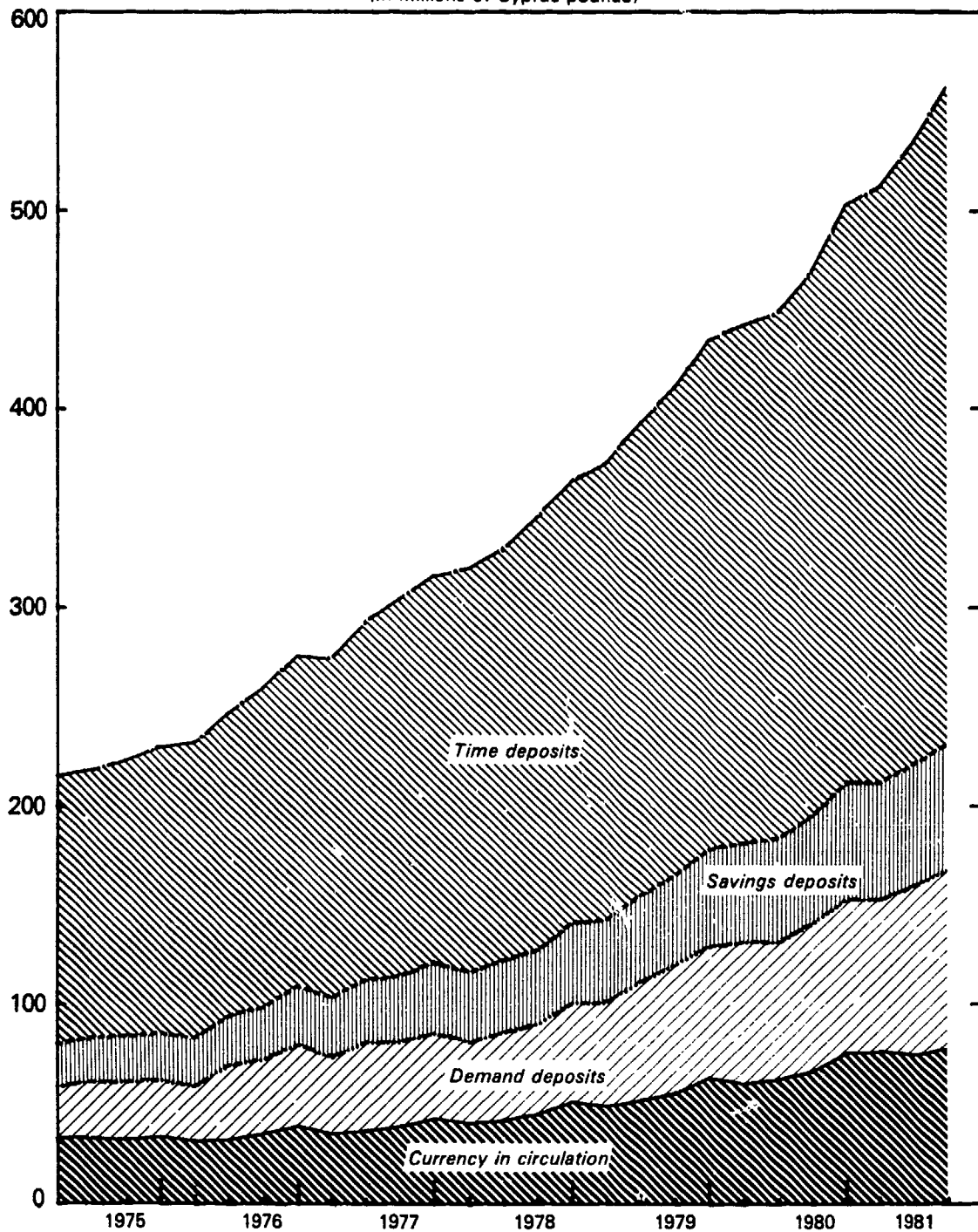
CHART 4
CYPRUS
MONETARY DEVELOPMENTS, 1975(I)-81(III)

(In millions of Cyprus pounds)



Sources: Central Bank of Cyprus, Bulletin; and data provided by the Cypriot authorities.

CHART 4, continued
CYPRUS
MONETARY DEVELOPMENTS,
1975 1st Quarter - 81 3rd Quarter
(In millions of Cyprus pounds)

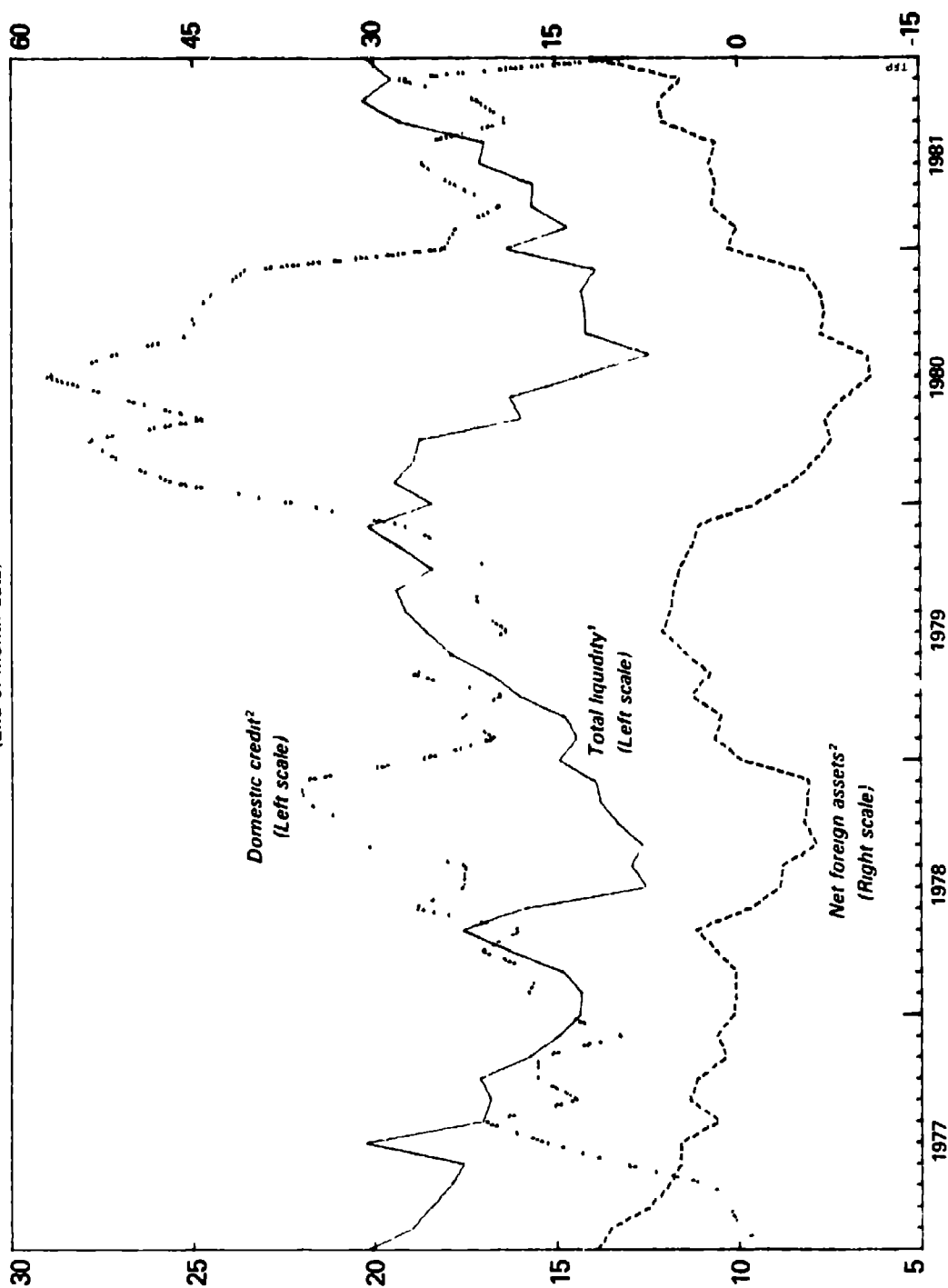


Source: Central Bank of Cyprus, *Bulletin*.

CHART 5
CYPRUS

SOURCES OF MONETARY EXPANSION

(End of month data)

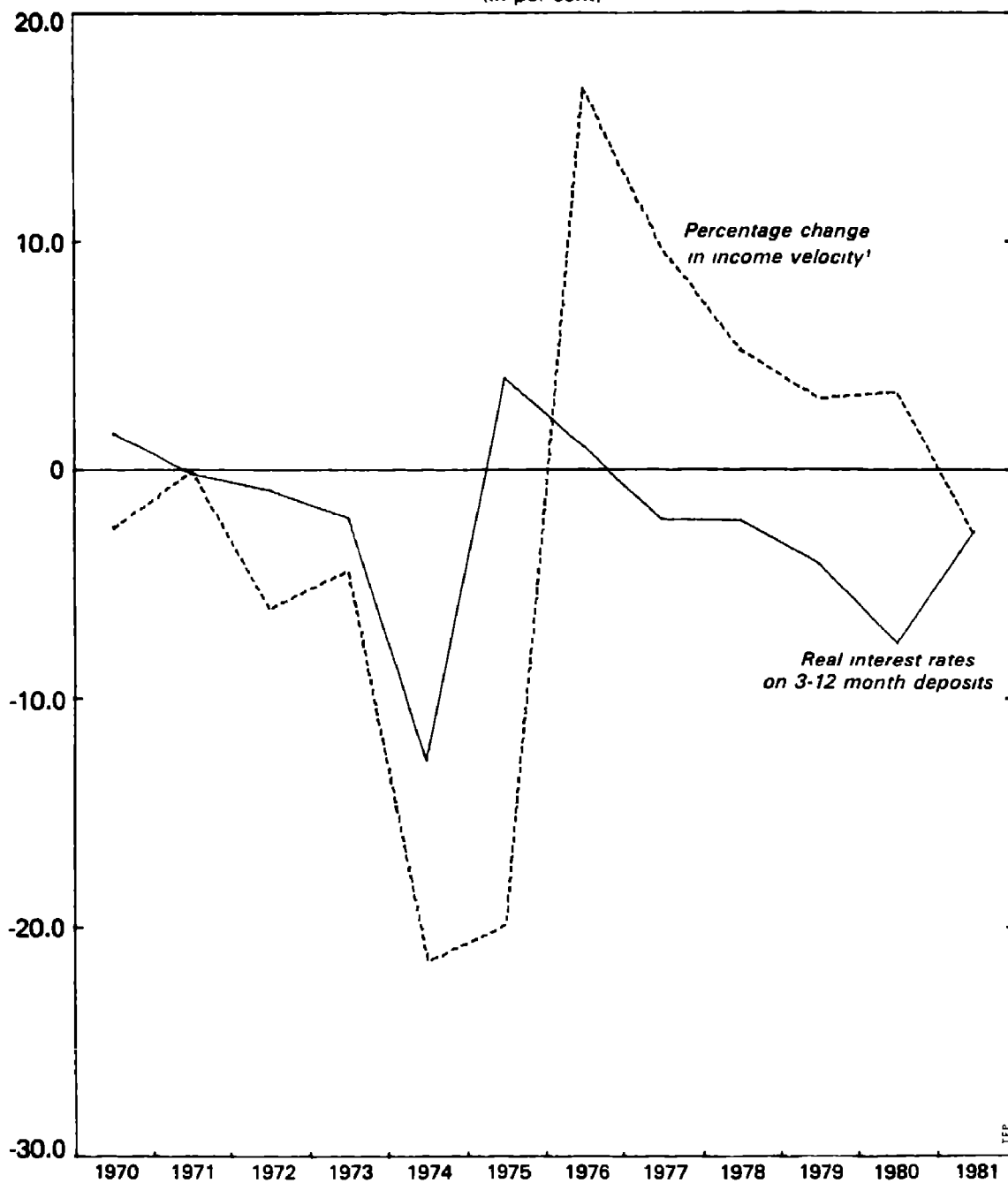


Sources: Central Bank of Cyprus Bulletin and data provided by the Cypriot authorities.

¹Percentage change in total money stock over previous 12 months

²Changes during previous 12 months as percentage of money stock at beginning of period

CHART 6
CYPRUS
VELOCITY AND INTEREST RATES
(In per cent)



¹Percentage change in the ratio of nominal GDP to average stock of broad money

²Projection

context of concomitant developments in net foreign assets (Chart 4). As government borrowing from the Central Bank in particular reached its statutory limits, equivalent to 55 per cent of ordinary government revenues, the Government increased its foreign borrowing. On adjustment of the net claims on the public sector for the Government's foreign borrowing, the total contribution of the Government to liquidity growth during the program year may be put at 50 per cent.

The budget deficit of the Government rose from about £C 39 million in 1979 to £C 57 million by the end of 1980 and to £C 67 million by the end of the third quarter of 1981, requiring large increases in domestic and foreign borrowing. The nonmonetary proportion involved appears to have been small, a factor that may be said to have been partly responsible for the failure to observe the credit ceiling decreed for the public sector over the program year.

Total net domestic credit expansion accelerated between 1977 and mid-1980 from 20 per cent to some 34 per cent per annum. It declined to 29 per cent in the third quarter of 1980 as the large decline in credit expansion to the private sector more than compensated for the continued increase in credit expansion to the public sector. The largest reduction during the year of the stabilization program occurred in the fourth quarter of 1980, when net domestic credit expanded by 20 per cent, down 9 percentage points from the preceding quarter, as a result of the large deceleration in credit expansion to private and public sector alike. In the remaining two quarters of the program year to mid-1981 credit expansion slowed further by 1 1/2 percentage points and 2 percentage points, respectively. In the third quarter of 1981 a further drop of 3 percentage points was recorded. These developments are reflected in the contribution of net domestic credit expansion to growth in total liquidity, which rose from 19 per cent to 29 per cent between the end of 1978 and mid-1980. The subsequent decline to mid-1981 was most pronounced in the fourth quarter of 1980, and relatively modest thereafter (Chart 5 and Table 21).

Net foreign assets of the banking system were subject to a worsening drain between 1978 and mid-1980 as net capital inflows did not rise in step with the sharply widening deficit in the current account of the balance of payments. The largest losses occurred in the first half of 1980 when the current account deficit rose by an annual rate of 60 per cent over the level of 1979, while net capital inflows remained unchanged. The situation was reversed in the second half of the year as the current account improved by 56 per cent and capital inflows more than doubled, so that at end-1980 total net foreign assets were £C 2 million above their end-1979 values. At the end of the program year, official net foreign assets, exclusive of net claims under payments agreements, stood at £C 142.5 million, some 40 per cent above their mid-1980 value; by the end of September they had risen to £C 191.5 million, a level 63 per cent above that of a year earlier. However, total net foreign assets recovered less rapidly, owing in particular to the continuing rise in foreign liabilities of the Deposit Money Banks.

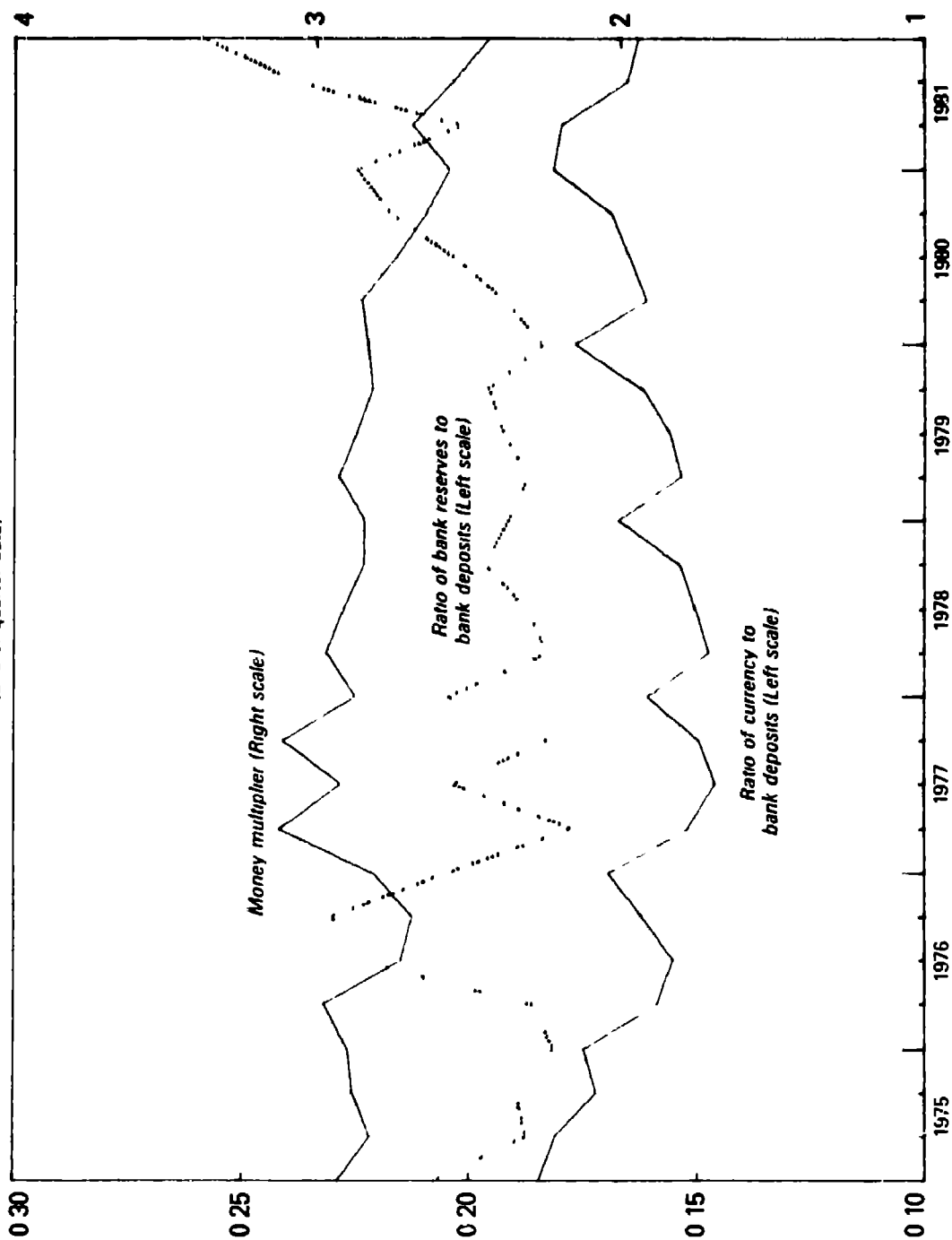
Reserve money growth, which had accelerated by an average of some 3 percentage points in 1978 and 1979, rose sharply by 8 percentage points during 1980, to a rate of 27.6 per cent. During the first half of 1981, growth slowed to 14.6 per cent at an annual rate, mainly because of the contraction that occurred during the first quarter; but by the end of September it had turned up again to a corresponding rate of 24.2 per cent. The dominant influence on recent reserve money developments has been credit creation to the public sector. From a proportion of about 7 per cent in 1978 net domestic credit to the public sector increased to 40 per cent by mid-1981, while the proportion of net foreign assets fell from 95 per cent to 68 per cent over the same time. The partial reversal of this tendency that became clearly apparent by the end of the third quarter of 1981--with net domestic credit to the public sector down to 27 per cent and with net foreign assets up to 83 per cent--but that had already begun during 1980, and is to be explained by the Government's increase in foreign borrowing. Through the increase in its net foreign borrowing, the Government has contributed to reserve money creation to a substantially greater extent than appears from the balance sheet of the Central Bank (Table 22).

3. The money multiplier

It is apparent from Chart 7 that in 1976/77 the sharp fall in the reserve ratio in the wake of the rapid recovery led to the largest rise in the money multiplier since 1975, notwithstanding the fact that the currency ratio declined. This had the effect of raising monetary expansion despite a more moderate growth in reserve money. During the remainder of 1977 and early in 1978 the multiplier fell, rose, and fell again, as the reserve and currency ratios--by moving in opposite directions in each instance--reinforced each other in their effects on the multiplier. For the remainder of 1978 and until the first quarter of 1980 inclusive the multiplier remained broadly stable and has therefore had no effect on the growth of money during that period. The multiplier then declined over the remaining three quarters of 1980 because of the large rise in the reserve ratio which more than compensated for the concomitant rise in the currency ratio. The rise in the reserve ratio may be attributed to the sharp decline in credit expansion to the private sector, and hence in its deposit growth, during the quarter preceding the stabilization program and during its early phase. Together with the reduction in the expansion of credit to the private sector, the decline in the multiplier helped to restrain the expansion of total liquidity in the face of continuing high growth in reserve money. During 1981 the multiplier rose in the first quarter but fell in the second quarter to a level slightly below that of end-1980. This particular decline is again associated with both a rise in the reserve ratio and a fall in the currency ratio, reinforcing each other in their combined effect on the multiplier. Over the period under review in Chart 7, the reserve ratio does not exhibit any trend influence, while the currency ratio has fluctuated first around a declining trend between 1975-77 and around a rising trend since then. These trend influences appear to be related to developments in the real interest rate (Chart 6). The opportunity costs of holding narrow money are relatively

CHART 7
CYPRUS
MONEY MULTIPLIER

(End of quarter data)



Sources: Central Bank of Cyprus Bulletin and IMF International Financial Statistics

high when the real interest rate on time deposits is positive, which it generally was during 1975-77, and relatively low when the real interest rate is negative, which it has increasingly become since then, at least up to 1980.

The authorities have not made any effort since 1978/79 to affect the multiplier by altering the reserve ratio. Both the "minimum liquidity requirement ratio" and the "minimum reserve requirement ratio" have remained unchanged at 23 per cent and 12 per cent, respectively (Table 23). The "excess liquidity ratio," the difference between the total liquidity ratio and the "required liquidity ratio," after being negative between 1979 and mid-1980 as a result of the rapid credit expansion, was positive during the early part of the stabilization program when credit expansion declined sharply. After having become temporarily negative early in 1981, it has risen rapidly since then. Excess liquidity, while serving as an indicator of bank lending, has not been per se an incentive or disincentive to credit expansion, because the amounts involved have been small, on the order of fC 2-3 1/2 million.

4. Interest rates

Data on nominal interest rates reflect the apparently broadly based preference in the society for low and stable rates which are fixed by law. The official discount rate and the Treasury bill rate have been unchanged since 1971, amounting to 6 per cent and 5.5 per cent, respectively (Table 24). The seven-day and one-month central bank deposit rates have equally remained constant at respective rates of 4.5 per cent and 5 per cent. The authorities raised the minimum reserve rate by half a percentage point to 5.5 per cent after the 1974 hostilities in an effort to increase bank liquidity and compensate the banks for abolishing commissions they had previously charged on their lending. Accordingly, even though the maximum interest payable on advances and loans remained unchanged at 9 per cent, effective lending rates were reduced to boost demand for credit. The interest rates on deposits were changed to encourage longer-term fixed deposits of large amounts, to help the banks improve the maturity structure of their deposit liabilities and promote longer-term bank lending. Thus, the maximum interest rate on time deposits for balances over fC 50,000 to be held for at least 12 months was raised by 2 percentage points to a level of 7 per cent. At the same time, the rates on shorter-term, lower amount, deposits were either reduced or abolished. The rate on demand deposits in excess of fC 15,000 was reduced from 2.5-3.0 per cent to 2 per cent, while the minimum interest-bearing amount on demand deposits was set at fC 1,000, thus abolishing interest payments on deposits of smaller amounts. Since that time interest rates on time deposits have been changed. With the intent, again, to improve the maturity structure of deposit liabilities, a 4.5 per cent rate was allowed to be paid on time deposits of up to fC 5,000, and a 4 3/4 per cent rate on balances in excess of this amount, that require seven days' notice for withdrawal. Treasury paper has recently been made more attractive. Issued at 8 per cent it has found subscribers among banks but, in particular and to a substantial extent, among individuals, insurance companies,

and provident funds, improving thereby the prospects for nonmonetary financing of the government deficit. Further, in contrast to earlier practices, the price of outstanding paper has recently been allowed to decline as the interest rates on new paper is increased.

The problem of negative real interest rates is not new. As apparent from Chart 6, rates had become even more substantially negative by the time immediately preceding the 1974 events than they were in 1980. From a positive real interest rate of some 2 per cent in 1970, given the nominal interest rate of 4 per cent and the 2 per cent rise in consumer prices, the real interest rate fell progressively on account of the fixed nominal interest rate and the accelerating price increases. By 1974 the real interest rate had fallen to a level of -13 per cent. Had it not been for the events of mid-1974 which temporarily reduced wages and arrested inflation so that the real interest rate improved sharply becoming positive in 1975/76, pressure to reform the way in which interest rates are determined would have built up much before 1979 when the real interest rate was again significantly negative. In 1981, for the first time since before the hostilities of 1974, the real interest rate and velocity moved in "normal" directions. With the substantial deceleration of inflation the real interest rate improved, while velocity fell as the flight out of money lost momentum. The argument made by the public that an increase in nominal interest rates raises inflation is not necessarily valid over the medium term. On the contrary, such an increase is likely to reduce inflation for the following reasons: (i) it will raise productivity by improving the allocation of financial resources, (ii) it will reduce the currency to deposit ratio and hence the money multiplier, (iii) it will reduce velocity, (iv) it will reduce the erosion of real savings and hence may moderate wage and salary claims, and (v) it will make it possible to increase the nonmonetary share in the financing of the Government's budget deficit and build-up of cash balances. In addition, it would promote a better composition of absorption and hence a more "sustainable" current account position of the balance of payments by attracting funds from abroad, reducing the incentive for capital outflows provided at present by the differential between foreign and domestic interest rates, and by improving prospects for a decline in foreign debt over the longer run. Finally, it would help to find an appropriate level for the exchange rate.

5. Operations of lending institutions

The pace at which Deposit Money Banks expanded their total assets in both 1980 and 1981 remained at about 20 per cent virtually the same as in 1979, but the composition changed (Table 25). Advances and loans, whose share in total assets fell from 71 per cent in 1979 to 67 per cent in 1980, and to 63 per cent by end-September 1981, rose in 1980 by 13.5 per cent, or 8 percentage points less than the year before, to a level of £C 403 million; in the year to end-September 1981 they rose by 14.2 per cent to £C 430 million. Holdings of Treasury bills, on the other hand, which had declined by £C 2 million during 1978-79, rose during 1980 by £C 13.5 million or 75 per cent to a level of £C 31.6 million, and during the first nine months of 1981 to a level of £C 37.1 million, illustrating

the disparate developments in credit to the private and public sectors. The earlier decline in the rate of expansion in foreign assets continued in 1980 and 1981 amounting to some 11 per cent and some 14 per cent, respectively, compared with 28.5 per cent in 1979. By contrast, cash and balances with the Central Bank continued to rise at an increasing rate, from 13.3 per cent in 1979 and 41.5 per cent in 1980 to 85.7 per cent in the year ending in September 1981, reaching at that time £C 123.7 million and leaving the banks very liquid.

Data on the sectoral distribution of Deposit Money Banks' advances and loans show that loan expansion declined most markedly to the sector of foreign and domestic trade, and in "personal loans." Loans to foreign and domestic trade which had risen at a rate of some 21 per cent during 1979 rose by 12 per cent in 1980 and by 7.7 per cent during the year ending in September 1981, reflecting the speculative build-up of inventories before mid-1980 and the subsequent destocking during the year of the stabilization program. By contrast, decline in loan expansion to the building and construction sector and to mining and manufacturing were less pronounced, reflecting in the former case the continuing need to settle refugees.

Total assets of "other financial institutions" ^{1/} rose by 16.1 per cent in the year to December 1980 (Table 27), about the same amount as in 1979, but down substantially from the rates of 24 per cent in 1977 and 20 per cent in 1978. In the year to September 1981, expansion amounted to no more than 8 per cent. While during 1977 lending by these institutions outpaced lending by the Deposit Money Banks, the reverse applies to the years of 1978 to 1981. In part this reversal is due to the relatively more rapid expansion of credit to the tourist sector in particular, which accounts for a rising share in total lending of the Deposit Money Banks, while total loans of the financial institutions consist, to about 50 per cent, in loans to the building and construction sector whose rate of expansion slowed considerably in 1980. The reversal is further attributable to the fact that the surge in bank lending during the year and a half to mid-1980, in connection with the build-up of inventories and the rise in consumption expenditures, has been mainly accounted for by the Deposit Money Banks. The new Five-Year Plan for 1982-86 envisages incentives to innovation in which the Cyprus Development Bank in particular might play an important role, perhaps sharing the risk involved in potentially highly productive investment projects.

In the calculation of monetary aggregates only deposits with Deposit Money Banks (DMBs) are currently included. Deposits with the Co-operative Central Bank--which is a DMB--are included while those of other cooperative financial institutions such as credit societies (CSs) and savings banks (SBs)--for which no balance sheets are available--and those of "other financial institutions" (OFIs) are not included. At the end of 1980

^{1/} The Mortgage Bank of Cyprus, Ltd., Lombard Banking, Ltd., and the Cyprus Development Bank, Ltd.

total deposits with DMBS reached LC 463.5 million while deposits with OFIs, CSs and SBs were LC 175.8 million. Thus, total deposits--including an unidentified amount of double counting between the Co-operative Central Bank and CSs and SBs--at the end of 1980 were LC 639.3 million with the share of deposits not included in monetary aggregates to total deposits being 27.5 per cent. To establish an historical record of the respective growth in these two groups it is noted that in 1978, 1973, 1968 and 1962 this ratio was respectively, 29.5 per cent, 31.1 per cent, 25.6 per cent, and 14.4 per cent. Thus, there was an increase in the share of these deposits vis-à-vis deposits with DMBS throughout the 1960s and the early 1970s followed by a decline throughout the middle and late 1970s which appears to continue to date.

Table 22. Cyprus: Monetary Indicators, 1977-81

(Percentage changes over preceding 12 months; end of period)

	1977	1978	1979	1980				1981		
				I	II	III	IV	I	II	III 1/
Money supply	6.0	17.0	26.6	29.5	18.0	17.1	18.4	16.4	21.5	19.8
Currency in circulation	9.4	18.0	21.3	24.0	19.8	18.3	18.7	26.9	19.5	16.9
Demand deposits	2.5	16.0	32.1	34.7	16.5	16.1	18.1	7.5	-3.1	22.4
Quasi-money	17.9	14.1	15.4	14.7	13.0	13.2	14.8	15.2	18.4	20.4
Savings deposits	21.9	13.7	21.1	21.1	20.6	20.6	19.6	17.4	17.6	16.2
Time deposits 2/	17.2	14.2	14.4	13.6	11.6	11.8	13.9	14.9	18.5	21.2
Total liquidity	14.4	14.9	18.5	18.8	14.4	14.4	15.9	15.6	19.3	20.2
Foreign assets, net	1.2	-0.5	-4.9	-27.0	-37.1	-25.6	2.1	10.6	38.7	66.0
Domestic credit, net	20.0	24.0	25.9	32.4	34.2	29.4	20.1	18.5	16.4	13.4
Of which:										
Private sector	26.6	17.9	21.8	23.1	21.5	17.6	13.5	12.8	12.8	13.9
Reserve money	12.9	16.1	19.7	21.7	19.7	21.8	27.6	22.6	28.1	30.2

Sources: Central Bank of Cyprus, Bulletin; and data provided by the Cypriot authorities.

1/ Provisional.

2/ Includes balances of Other Financial Institutions with the Central Bank.

Table 23. Cyprus: Monetary Survey, 1978-81
(In millions of Cyprus pounds; end of period)

	1979	1980	1981 Sept.	1978	1979	1980				1981		
						I	II	III	IV	I	II	III 1/
						Absolute change over preceding 12 months						
Position at end-period												
Foreign assets, net	102.2	104.3	141.9	-0.6	-5.3	-29.0	-42.4	-29.5	2.1	8.3	27.9	56.4
Official reserves 2/	130.1	142.0	192.3	2.0	1.5	-20.9	-36.4	-24.0	11.9	15.3	40.6	74.0
Deposit money banks	-25.6	-37.3	-49.5	-0.8	-8.1	-8.8	-6.8	-7.6	-11.7	-8.3	-13.6	-17.0
Payments agreements	-2.3	-0.4	-1.0	-1.8	1.3	0.7	0.8	2.1	1.9	1.3	0.9	-0.6
Domestic credit, net	388.8	466.9	513.7	59.7	80.0	103.8	113.7	102.8	78.1	78.6	73.0	60.8
Public sector	32.1	62.0	83.0	15.2	16.2	33.5	45.7	46.2	29.9	31.1	23.8	8.3
Central Government	31.8	57.0	82.3	20.5	12.4	28.3	39.7	40.3	25.2	26.0	21.0	7.6
Government agencies	3.3	5.0	5.7	-2.3	3.8	5.2	3.1	2.9	1.7	2.1	2.8	0.7
Other 3/	-3.0	--	--	-3.0	--	--	3.0	3.0	3.0	3.0	--	--
Private sector	356.7	404.9	430.7	44.5	63.8	70.3	68.0	56.6	48.2	47.5	49.2	52.5
Other items, net	-58.4	-70.0	-92.4	-11.7	-7.1	-5.0	-14.7	-14.5	-11.6	-17.8	-14.5	-22.6
Broad money	432.5	501.2	563.3	47.4	67.6	69.9	56.5	58.7	69.9	69.1	86.4	94.6
Money supply	129.5	153.3	169.0	14.9	27.2	30.0	20.1	20.6	23.8	21.6	28.3	27.8
Currency in circulation	64.0	75.9	78.0	8.1	11.3	11.7	10.3	10.3	11.9	16.3	12.3	11.2
Demand deposits	65.5	77.4	91.0	6.8	15.9	18.3	9.8	10.3	11.9	5.3	16.0	16.6
Quasi-money	303.0	347.9	394.3	32.5	40.4	39.9	36.4	38.1	46.1	47.5	58.1	66.8
Savings deposits	49.1	58.7	62.9	4.9	8.5	8.7	8.9	9.2	9.6	8.7	9.2	8.8
Time deposits	253.9	289.2	331.4	27.6	31.9	31.2	27.5	28.9	35.3	38.8	48.9	58.0
Memorandum items:												
Percentage changes in:												
Broad money	...	...	...	14.9	18.5	18.8	14.4	14.3	16.2	15.6	19.3	20.2
Contribution to growth from: 4/												
Domestic credit, net	...	...	...	18.8	21.9	27.9	29.0	25.1	18.1	17.8	16.3	13.0
Foreign assets, net	...	...	...	-0.2	-1.5	-7.8	-10.8	-7.2	0.5	1.9	6.2	12.0
Other items, net	...	...	...	-3.7	-1.9	-1.3	-3.8	-3.5	-2.7	-4.0	-3.2	-4.8
Income velocity	1.57	1.62	1.57 1/	...	...	...	...	...	...	...	...	...

Sources: Central Bank of Cyprus, Bulletin; and data provided by the Cypriot authorities.

1/ Provisional.

2/ Includes holdings of SDRs, the government holdings of foreign exchange and reserve position in IMF.

3/ Reserve position in IMF.

4/ Change over the preceding 12 months as percentage of initial money stock.

Table 24. Cyprus: Reserve Money, 1977-81

(In millions of Cyprus pounds; end of period)

	1977	1978	1979	1980				1981		
				I	II	III	IV	I	II	III 1/
Net foreign assets	124.5	121.4	124.1	103.7	99.8	117.1	140.8	123.2	141.7	190.8
Foreign assets 2/	126.3	125.0	126.4	105.7	101.5	117.5	141.2	123.9	142.5	191.8
Payments agreements, net	-1.8	-3.6	-2.3	-2.0	-1.7	-0.4	-0.4	-0.7	-0.8	-1.0
Net claims on public sector	-12.2	9.5	33.8	58.7	74.0	72.7	59.7	77.4	83.0	61.4
Central Government										
Advances	--	6.0	23.5	30.6	31.3	35.5	35.5	38.5	39.0	29.5
Treasury bills 3/	3.2	13.2	17.0	25.5	40.6	33.0	31.6	33.9	41.0	27.9
Deposits	-17.3	-9.9	-12.0	-3.0	-2.1	-1.8	-13.8	-2.0	-3.3	-2.1
Government agencies	1.9	0.2	5.3	5.6	4.2	6.0	6.4	7.0	6.3	6.1
Credit to banks 4/	5.7	6.2	11.4	12.1	13.2	14.5	16.4	17.1	16.3	16.9
Deposits of other financial institutions	-4.1	-5.0	-7.1	-5.6	-5.8	-6.0	-6.5	-6.2	-6.9	-6.7
Other items, net	-3.7	-4.2	-9.1	-13.8	-17.6	-20.9	-15.0	-21.3	-24.5	-31.5
Reserve money	110.2	127.9	153.1	155.1	163.6	177.4	195.4	190.2	209.6	230.9
Currency outside banks	44.7	52.7	64.0	60.6	62.5	66.7	75.9	76.9	74.8	77.9
Currency in banks	2.6	3.2	4.0	3.1	3.9	4.5	4.8	4.1	4.7	4.6
Bank's deposits	62.9	72.0	85.1	91.4	97.2	106.2	114.7	109.2	130.1	148.4

Sources: Central Bank of Cyprus, Bulletin; and IMF, International Financial Statistics.^{1/} Provisional.^{2/} Includes holdings of SDRs, but excludes government holdings of foreign exchange and reserve position in IMF.^{3/} Includes a small amount of government securities, but excludes government guaranteed securities.^{4/} Includes credit granted to banks under the Fund for Financing of Priority Projects, which amount to £C 8.9 million at end-1979.

Table 25. Cyprus: Liquidity of all Banks 1/

(End of period)

	1977	1978	1979	1980				1981	
				I	II	III	IV	I	II
									2/
(In millions of Cyprus pounds)									
Total liquid assets, net	79.6	85.7	90.1	94.4	95.8	115.0	122.5	111.0	124.6
Domestic 3/	76.0	80.6	83.5	88.4	88.8	107.7	117.3	102.1	113.4
Foreign 4/	3.6	5.1	6.7	6.0	7.0	7.3	5.2	8.9	11.2
Liquid assets	6.9	8.7	12.3	11.4	11.8	12.6	12.2	15.4	19.1
Short-term liabilities	-3.3	-3.6	-5.7	-5.4	-4.8	-5.3	-7.1	-6.5	-7.9
Total bank deposits 5/	314.6	364.8	429.8	446.3	450.8	471.1	494.3	503.0	530.6
Minimum liquidity requirement 6/	72.4	76.6	98.8	102.6	103.7	108.4	113.7	115.7	122.0
Minimum reserve requirement	37.8	43.8	51.6	53.6	54.1	56.5	59.3	60.4	63.7
(As per cent of total bank deposits)									
Liquidity ratio	25.3	23.5	21.0	21.1	21.2	24.4	24.8	22.	23.5
Required liquidity ratio 6/	23.0	21.0	23.0	23.0	23.0	23.0	23.0	23.0	23.0
Excess liquidity ratio	2.3	2.5	-2.0	-1.9	-1.8	1.4	1.8	-0.9	0.5

Sources: Central Bank of Cyprus, Bulletin; and data provided by the Cypriot authorities.

1/ Including commercial banks and other financial institutions.

2/ Provisional.

3/ As of July 1979 it includes cash, Central Bank balances, and Cyprus Treasury bills; previously it included also local drafts, checks and bills sought.

4/ Includes foreign currency checks, bills, and net short-term balances with foreign banks.

5/ Excluding "special deposits."

6/ Excluding compulsory contributions to the Fund for Financing Priority Projects, presently amounting to 6 per cent of eligible deposits.

Table 26. Cyprus: Selected Interest Rates, 1971-81

(In per cent per annum)

	<u>1971</u> December	<u>1975</u> December	<u>1979</u> December	<u>1980</u> December	<u>1981</u> September
Discount rate	6.0	6.0	6.0	6.0	6.0
Treasury bills	5.5	5.5	5.5	5.5	5.5
Central bank deposits					
Seven days	4.5	4.5	4.5	4.5	4.5
One month	5.0	5.0	5.0	5.0	5.0
Minimum reserves	5.0	5.0-5.5	5.0-5.5	5.0-5.5	5.0-5.5
Commercial banks					
Demand deposits					
Up to £C 1,000	2.0 <u>1/</u>	2.0 <u>1/</u>	--	--	--
Over £C 1,000	2.5-3.0 <u>2/</u>	2.0 <u>1/</u>	2.0	2.0	2.0
Savings deposits	3.5-4.0	4.0	4.0	4.0	4.0
Time deposits					
Minimum <u>3/</u>	...	...	4.5	4.5	4.5
Maximum	4.0-5.0	Up to 7.0	7.0	7.0	7.0
Advances and loans	7.5-9.0	Up to 9.0	Up to 9.0	Up to 9.0	Up to 9.0

Source: Central Bank of Cyprus, Bulletin.

1/ Applies to balances of £C 15,000.

2/ Applies to balances in excess of £C 15,000.

3/ Applies to balances up to £C 5,000 which require seven days' notice for withdrawal.

Table 27. Cyprus: Assets and Liabilities of Deposit Money Banks, 1977-81

(End of period)

	1978	1979	1980	<u>1981 1/</u> <u>Sept.</u>	1977	1978	1979	1980	<u>1981 1/</u> <u>Sept.</u>
	In millions of Cyprus pounds				Percentage change over preceding 12 months				
Assets									
Cash and balances with the Central Bank	58.5	66.2	93.7	123.7	15.2	6.8	13.2	41.5	43.5
Foreign assets	10.5	13.5	15.0	19.8	-10.0	50.0	28.5	11.3	38.5
Local investment	22.1	19.5	33.0	39.0	-37.0	-1.1	-11.8	69.2	31.3
Of which:									
Treasury bills	20.7	18.1	31.6	37.1	-39.3	-1.0	-12.6	74.6	31.1
Advances and loans <u>2/</u>	292.0	354.9	402.8	429.6	26.8	18.0	21.5	13.5	14.2
Other assets <u>3/</u>	36.7	48.6	59.3	74.3	18.2	16.6	32.4	22.0	10.2
Assets = Liabilities	419.8	502.7	603.8	686.4	16.2	15.7	19.7	20.1	19.7
Liabilities									
Deposits <u>4/</u>	333.7	398.4	463.5	536.7	16.4	15.3	19.4	16.3	22.6
Demand	55.2	69.4	79.7	95.9	10.2	11.5	25.7	14.8	23.6
Savings	42.0	51.0	61.2	65.5	21.6	13.9	21.4	20.0	16.3
Time	236.5	277.9	322.7	375.3	17.1	16.4	17.5	16.1	23.5
Liabilities to foreign banks	3.6	5.7	7.1	9.4	23.6	4.9	58.3	24.6	77.4
Capital and reserves	48.3	51.4	60.7	68.1	16.4	23.0	6.4	18.1	16.8
Other liabilities <u>5/</u>	34.2	47.3	72.5	72.2	13.4	11.1	38.3	53.3	0.4
Of which:									
Borrowing from Central Bank	6.2	11.4	16.4	16.9	103.6	8.8	83.9	43.9	16.6

Sources: Central Bank of Cyprus, Bulletin; and data provided by the Cypriot authorities.1/ Provisional.2/ Includes small amount of bills discounted.3/ Includes holdings of local private short-term paper and stocks, advances and loans to other institutions, fixed assets, and other.4/ Includes deposits held by foreign residents.5/ Includes deposits of other financial institutions, advances and loans from other financial institutions, borrowing from the Central Bank and other.

Table 28. Cyprus: Advances and Loans by Deposit Money Banks and Other Financial Institutions, 1977- 81

(End of period)

	1978	1979	1980	1981 1/ Sept.	1977	1978	1979	1980	1981 1/ Sept.
In millions of Cyprus pounds	Percentage change during preceding 12 months								
	(Deposit Money Banks)								
Agriculture	23.2	23.5	24.9	25.1	7.5	10.8	1.3	6.0	11.6
Mining and manufacturing	75.8	94.4	111.9	128.4	39.1	24.1	24.5	18.5	23.5
Tourism	11.5	14.8	19.6	22.8	14.5	27.1	28.7	32.4	33.3
Transport and communication	3.1	4.3	4.7	5.9	42.0	12.8	38.7	9.3	51.3
Foreign and domestic trade	97.1	117.8	132.0	135.1	28.5	15.7	21.3	12.1	7.7
Building and construction	37.9	45.9	52.2	57.9	14.1	18.9	21.1	13.7	16.0
Personal loans	29.0	32.2	33.0	33.4	50.4	12.4	11.0	2.5	3.7
Loans to public sector	7.8	10.7	10.8	9.5	12.4	0.2	37.2	0.9	-12.1
Bills discounted	6.6	11.2	13.7	11.5	-7.0	57.6	69.7	22.3	10.6
Total	292.0	354.8	402.8	429.0	26.8	18.0	21.5	13.5	14.2
	(Other Financial Institutions)								
Agriculture	1.0	0.9	1.2	1.2	21.7	-4.5	-10.0	33.3	9.1
Manufacturing	6.9	8.3	9.5	9.5	19.8	17.3	20.3	14.5	5.6
Tourism	8.8	10.6	12.6	13.1	14.8	34.4	20.5	18.9	15.9
Foreign and domestic trade	0.7	0.7	0.7	0.6	33.5	-0.6	--	--	--
Building and construction	27.0	28.9	30.4	31.0	41.7	15.2	7.0	5.2	9.9
Personal loans	4.9	5.0	8.1	7.3	13.4	0.8	2.0	62.0	-3.0
Other	0.6	0.9	1.3	1.2	--	60.0	50.0	44.0	--
Total	49.9	55.3	63.8	63.9	29.3	17.3	10.8	15.4	...

Sources: Central Bank of Cyprus, Bulletin; and data provided by the Cypriot authorities.

1/ Provisional.

Table 29. Cyprus: Assets and Liabilities of Other Financial Institutions, 1976-81 ^{1/}

(End of period)

	1978	1979	1980	1981 ^{2/} Sept.	1977	1978	1979	1980	1981 ^{2/} Sept.
	In millions of Cyprus pounds				Percentage change over preceding 12 months				
Assets									
Local investments	1.9	2.0	2.3	2.4	50.4	42.4	5.3	16.0	4.3
Advances and loans	49.9	55.4	63.8	63.9	29.3	17.3	11.0	15.2	8.3
Other assets ^{3/}	11.4	15.8	18.9	23.9	2.5	28.1	39.5	19.6	8.1
Assets = liabilities	63.2	73.2	85.0	90.2	24.3	19.8	15.8	16.1	8.2
Liabilities									
Deposits	43.3	46.0	50.7	51.7	25.4	17.3	6.2	10.2	2.4
Of which:									
Time deposits	36.4	39.6	46.6	46.1	11.0	24.3	8.8	17.7	1.3
Capital and reserves	7.9	9.8	11.4	13.1	20.8	17.4	24.1	16.7	1.2
Other liabilities	12.0	17.4	22.9	25.4	22.5	31.7	45.0	31.6	16.0

Sources: Central Bank of Cyprus, Bulletin; and data provided by the Cypriot authorities.^{1/} Mortgage Bank of Cyprus Ltd.; Lombard Banking (Cyprus) Ltd.; and Cyprus Development Bank Ltd.^{2/} Provisional.^{3/} Includes small amounts of currency, foreign assets, government paper, and balances with the commercial banks and the Central Bank of Cyprus.

IV. Balance of Payments

1. Overview

Recent developments in the balance of payments reveal serious weaknesses. Cyprus experienced a persistent widening of the trade deficit, in part because aggregate demand began to exceed domestic supply and in part because of the increasing cost of imported energy. However, through 1978 the overall balance of payments remained positive, as the trade deficit was more than offset by an increasing surplus on the invisibles account, mainly from tourism, coupled with a substantial net capital inflow (Chart 8).

In 1979 the overall balance swung into deficit, which was second in magnitude only to the deficit recorded in 1975, following the mid-1974 events. During the first half of 1980 the deficit reached a record figure of £C 29.9 million, as the trade deficit was nearly twice as large as in the corresponding period of 1979 (Table 30). In the second half of 1980 imports decreased substantially in response to the stabilization measures of the Government which aimed at a reduction of domestic demand. At the same time, official long-term loans from abroad were twice as large as those for 1979 as a whole, leading to a small overall surplus in the balance of payments for the year 1980. While increasing in absolute terms, the current account deficit declined slightly in relation to GDP, from 11.5 per cent in 1979 to 10.8 per cent in 1980. Due to increased foreign borrowing, the total external debt increased during the same period from 24.8 per cent of GNP to 26.9 per cent, and debt servicing increased from 5.6 per cent of exports of goods and services to 6.9 per cent.

The favorable developments in the balance of payments in the second half of 1980 continued in the first half of 1981, but at a slower pace, as demand for imports revived and the pressure on the trade balance increased in spite of a good performance of exports. For the 12 months under the stabilization program (July 1980 to June 1981), the trade deficit amounted to £C 203.2 million, about £C 6 million less than anticipated. The export estimates for these 12 months were exceeded by £C 12.5 million, owing mainly to a higher rise in export volume than anticipated. Although imports fell by about £C 20 million in the second half of 1980, relative to the level a year earlier, due mainly to destocking, actual imports during the program year were still £C 6.1 million higher than foreseen; import prices were lower than estimated, but the volume of imports declined less than expected. With an invisibles surplus of about £C 6 million higher than expected, the current account deficit for the program year was £C 14.6 million below projections, and the overall balance was in surplus. In 1981 ^{1/} the invisible surplus and net capital inflows are expected to increase substantially, and the overall balance of payments will thus continue to register a surplus.

^{1/} The data for 1981 are official estimates of the Cypriot authorities based on developments through the first half or the first three quarters of the year.

2. Merchandise trade in 1980 and 1981

In 1980 the trade deficit rose to a record level of fC 208.3 million (SDR 453.6 million, Table 31); equivalent to 27.8 per cent of GDP. On a half-year basis, the trade deficit decreased in the second half of 1980, due mainly to a decrease in imports of about fC 20 million. The reduction in imports of durable goods, investment goods, fuels and lubricants, and transport equipment was due not only to the stabilization measures, but also to cyclical factors. The volume of imports and exports rose by 3.7 per cent and 7.1 per cent, respectively (Table 332, involving an increase in the ratio of exports (excluding re-exports) to imports in volume terms by 3.3 per cent in 1980, compared with 1.1 per cent in 1979. However, as import prices rose faster (14.4 per cent) than export prices (8.6 per cent), the terms of trade deteriorated by 5.0 per cent in 1980, compared with 3.3 per cent in 1979 (Chart 9).

In the first half of 1981, the trade deficit increased relative to the second half of 1980 but it remained below the level reached a year earlier, mainly on account of a substantial rise in exports of agricultural products, favored by good weather conditions and high prices abroad. In the second half of 1981 the trade deficit is estimated to increase as export expansion has eased somewhat, while imports have continued to rise. The trade deficit for the whole year of 1981 is expected to increase by some fC 20 million, but to decline slightly in relation to GDP to 26.6 per cent. In volume terms, imports and exports are expected to increase by 2 per cent and 9 per cent, respectively. But import prices are expected to rise more rapidly (11.9 per cent) than export prices (10.5 per cent) so that the terms of trade will continue to decline in 1981 by 1.3 per cent.

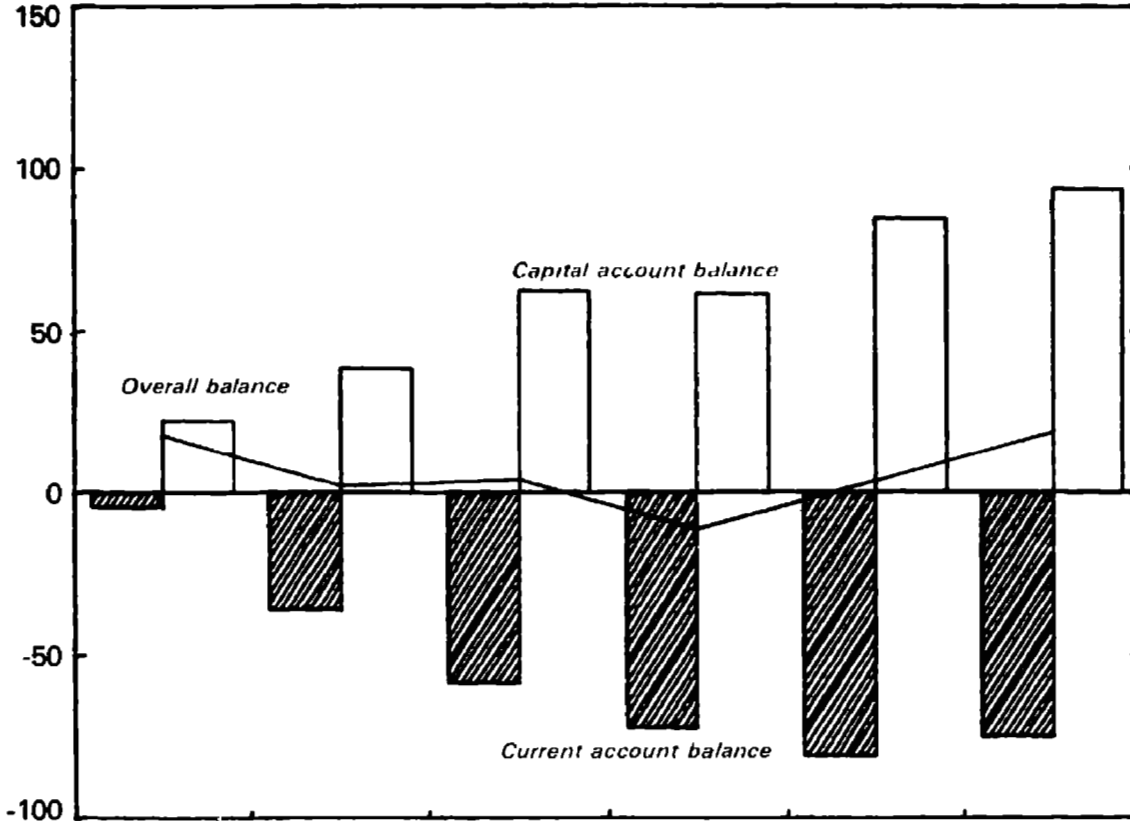
a. Exports

In 1980, the rate of increase of exports (in value terms and on a customs basis) slowed to 16.1 per cent, from 26.0 per cent in 1979, mainly because of a marginal decline in the exports of agricultural products, due to a poor agricultural season and a decline in the price of potatoes (Table 33). The rate of growth of domestic exports of manufactures slowed to 26.6 per cent, following an increase of 32.1 per cent in 1979, but their share in total domestic exports moved up to 50.9 per cent, while the share of agricultural exports diminished. The rate of growth of exports of beverages and tobacco picked up again from 2.9 per cent in 1979 to 9.7 per cent, but their share in total domestic exports continued to decrease to 10.6 per cent. Exports of minerals grew by 5.9 per cent compared with an increase of 21.4 per cent in the previous year, reflecting a sharp downturn in asbestos exports, and their share in total domestic exports fell from 6.7 per cent to 5.4 per cent.

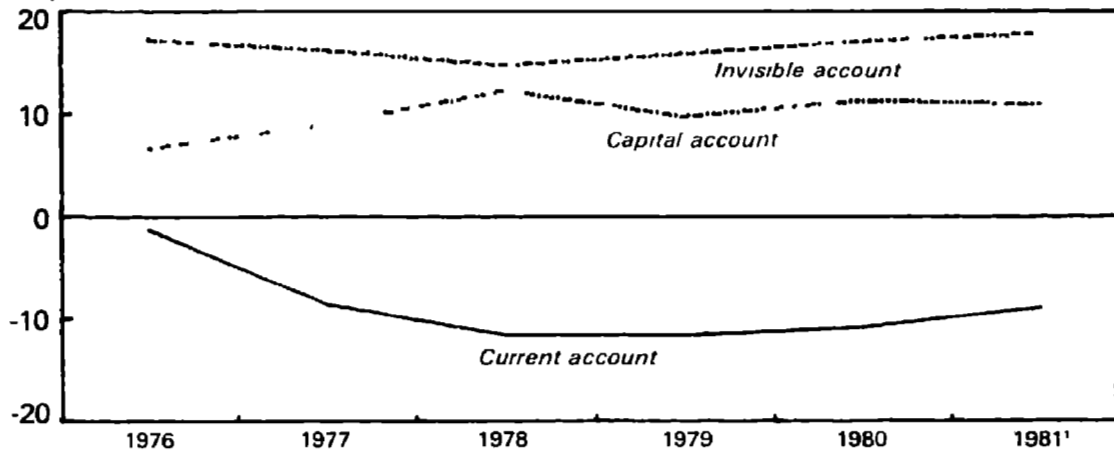
The main feature of domestic export developments from 1977 to 1980 was the fact that the value of exports of manufactured goods increased by 84.4 per cent while the value of the exports of food and live animals remained about the same, reflecting a partial transfer of national resources to the sectors with higher productivity. The most important factor behind

CHART 8
CYPRUS
BALANCE OF PAYMENTS

In millions of Cyprus pounds



In per cent of GDP

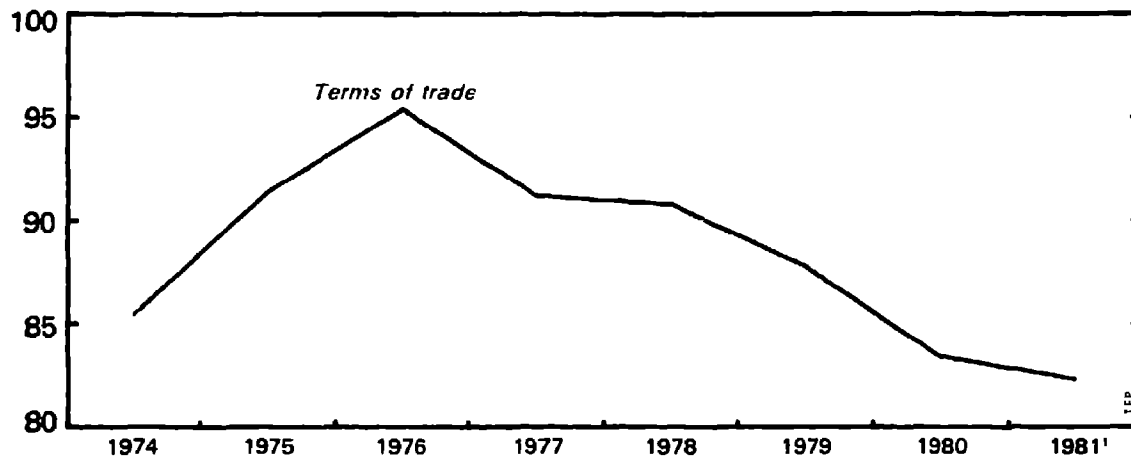
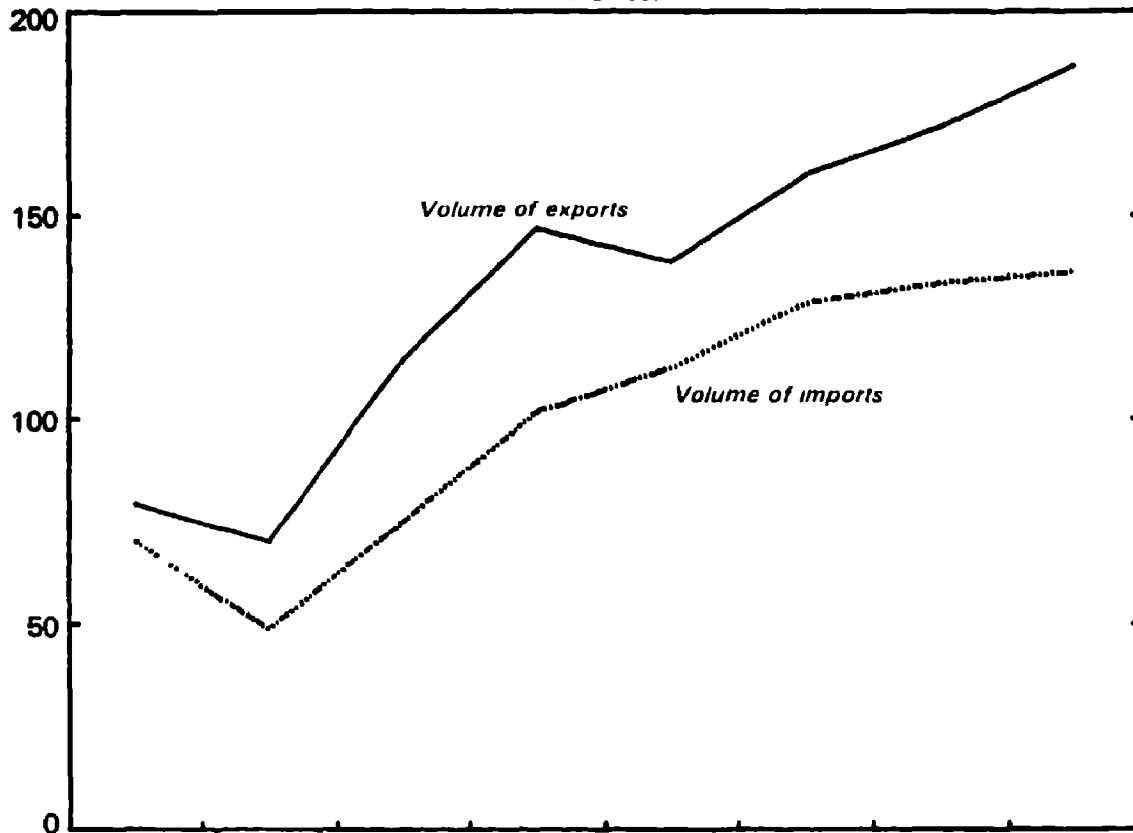


Sources: Central Bank of Cyprus *Bulletin*. Data provided by the Cypriot authorities.

¹Estimates

CHART 9
CYPRUS
VOLUME OF EXPORTS AND IMPORTS,
AND TERMS OF TRADE

(1973=100)



Sources: Central Bank of Cyprus *Bulletin* and Ministry of Finance *Imports and Exports Statistics*

¹Estimates

these developments was the export of clothing, which rose during that period by 132.5 per cent. The importance of this item reached a peak in 1979 when its share in the export of manufactured goods stood at 37.0 per cent (11 percentage points higher than in 1977), but it showed a slight decline in 1980. The exports of footwear, in value terms, almost doubled from 1977 to 1980.

The rise in domestic exports of the second half of 1980 continued in the first half of 1981, when they increased by 29.4 per cent, compared with 10.7 per cent in the first half of 1980 (Table 34). Exports of agricultural products, especially citrus and potatoes, contributed to this development, which was helped by favorable prices prevailing abroad, and the rise in the value of sterling vis-à-vis the Cyprus pound. At the same time, exports of manufactured goods (clothing, footwear, paper products, and cigarettes) continued the trend recorded in 1980; however, exports of cement dropped in the first half 1981 by 53.6 per cent, compared with the same period of 1980, reflecting a decline in demand from Syria, which takes about 84 per cent of total Cyprus cement exports.

Following an increase of 21.4 per cent in 1979, in value terms, re-exports consisting mainly of machinery and transport equipment, and watches and clocks, grew by only 16.1 per cent in 1980 as re-exports in the second half of 1980 increased only by 4.5 per cent. About half of the re-exports went to Arab countries, especially Lebanon which took one third of total re-exports. Greece, Nigeria and the United States were also important markets for re-exports. During the first half of 1981, re-exports, in value terms, remained at about the same level as in the first half of 1980.

b. Imports

After increasing by 27.0 per cent in 1979 the value of imports (c.i.f.) rose by 18.6 per cent in 1980. Much of this decline was due to destocking, especially in the second half of 1980. This followed speculative stockbuilding in the second half of 1979 and the first half of 1980, which was induced not only by the increasing negative real interest rate but also by the expectation of restrictive fiscal and monetary measures, which in fact were announced in the spring of 1980.

In 1980, imports of fuels and lubricants, according to customs data, grew again more quickly than other imports, by 76.4 per cent compared with an increase of 43.5 per cent in 1979, due partly to the increase in volume but mainly to rising oil prices. Their share in total imports, 13.9 per cent in 1977, expanded to 18.5 per cent in 1980, as Cyprus depends almost entirely on imported oil for its energy needs. While in 1979 it took about 35 per cent of total domestic export earnings to match the oil bill, in 1980 it took 53 per cent. In relation to GNP, the oil bill increased from 2.5 per cent in 1973 to 10.1 per cent in 1980. In order to offset partially the impact of oil costs on the balance of payments, efforts are being made to discourage imports of luxury and nonessential goods and to promote import substitution.

The rate of increase in imports of consumer goods diminished from 20.6 per cent in 1979 to 17.4 per cent in 1980, after a continuous acceleration during the previous two years. As a result, their share in total imports decreased to a 18.8 per cent, the lowest figure in the last six years. The slowdown was significant, especially for imports of durable goods.

After a 14 per cent increase in 1979, imports of capital goods grew by only 4.3 per cent in 1980. This reflects a general slack in the domestic investment. The relatively high increase in imports of capital goods in 1980 was recorded for the manufacturing sector while imports of capital goods for construction and mining and for agriculture decreased, reflecting a decline of the activities in these sectors, especially in construction.

Imports of intermediate inputs, ^{1/} accounting for 43.7 per cent of imports, decelerated too from 40.1 per cent in 1979 to 7.5 per cent in 1980, due mainly to the drawing down of stocks, especially of raw materials for industry. Imports of construction goods also diminished.

In the first half of 1981, as a result of the stabilization program, imports increased by 7.9 per cent in value terms, compared with the first half of 1980, implying a decline of about 4.0 per cent in real terms. But the imports of intermediate goods increased by 22.9 per cent, mainly due to the rise in imports of raw materials for the manufacturing sector. The imports of consumer goods decreased during the same period by 1.5 per cent, primarily because of a decrease in imports of durable and semidurable goods. The imports of fuel and lubricants increased by 19.0 per cent, as a result of an increase in oil prices and a rise in the value of the U.S. dollar against the Cyprus pound. In contrast, the imports of capital goods decreased by 21.9 per cent, reflecting the slackening industrial investment activity; the most marked decrease was registered by imports of capital goods for manufacturing. Imports of transport equipment, which largely comprises motor vehicles for private and for capital use, dropped by 18.3 per cent.

c. Direction of trade

The main change in the geographical distribution of exports and imports in 1980 was a decrease in the share of EC countries and an increase in the share of Arab countries which are Cyprus' main market for manufactured products (Table 35). The share of the United Kingdom, which is the main market for agricultural products, in total exports decreased from 25.4 per cent in 1979 to 20.8 per cent in 1980, partly due to cyclical reasons. On the import side the share decreased from 16.9 per cent to 15.4 per cent. The share of other EC countries in exports remained about the same, and in imports diminished slightly. At the same time, the

^{1/} Some intermediate goods imports apparently undergo very limited processing in Cyprus and should perhaps be classified as consumer goods.

share of oil-exporting countries in exports rose from 21.7 per cent in 1979 to 25.3 per cent in 1980, and in imports from 6.7 per cent to 11.2 per cent, reflecting mainly an increase in manufacturing exports and oil imports. After a small decline in 1979, the share of Lebanon in exports increased slightly to 9.9 per cent and on the import side the share remained about the same. Regarding the other Middle Eastern countries, their share both in exports and imports increased slightly to 11.8 per cent and 2.4 per cent, respectively. The share of exports to the CMEA countries increased from 5.2 per cent to 5.9 per cent, and on the import side the share increased slightly to 7.5 per cent. During the first half of 1981 no significant changes occurred in the regional development of foreign trade, except the increase in the share of United Kingdom in the total exports due to the recovery in agricultural exports.

3. International competitiveness and export performance

An analysis of the international competitiveness of Cyprus' manufacturing goods is hampered by the lack of data on, for example, unit labor costs and on costs and prices in Cyprus' competitor countries, which usually are not its main trading partners. In addition, in a small economy like Cyprus, individual projects and special contracts with overseas state enterprises (like that with the Libyan organization handling clothing and footwear) may raise export growth even when competitiveness declines.

According to calculations at the Central Bank, the real effective exchange rate of the Cyprus pound has recently shown little change vis-à-vis the currencies of its competitor countries. However, the terms of trade deteriorated for the fourth consecutive year. As imports are an important element of cost in the export sector, these developments may indicate reduced profit margins, especially for the firms exporting to Europe. The declining trend in the productive investment by the private sector is probably related to some extent to this fact. Moreover, the increases in wages were relatively high in 1979 and 1980 and went beyond the rise in productivity, although their level remained lower than in most partner countries in Europe. On the other hand, wages are believed to be higher in Cyprus than in partner countries of the Middle East and in competitor countries in Asia and North Africa. All in all, Cyprus gained 10.5 per cent in market shares in 1979, only 2.7 per cent in 1980, and 2.8 per cent in 1981 (Table 36).

4. Invisibles account

The traditional surplus in the invisibles account increased in 1980 by £C 28.3 million, to a level of £C 127.4 million, reflecting mainly a substantial increase in earnings from tourism (Table 37). The ratio of gross receipts from tourism to merchandise exports increased from 20 per cent in 1976 to 46 per cent in 1981. Net receipts from tourism increased in 1980 by 48.9 per cent to £C 50.7 million, representing 39.8 per cent of the total invisible surplus. They continued to increase in 1981 by 44 per cent, and accounted for 47.8 per cent of total invisible surplus.

The net earnings from other transportation also rose sharply to £C 17.8 million in 1980, and to £C 25.1 million in 1981 as a result of expanding tourism. In addition, in 1980 and 1981, the expenditure by foreign military forces increased to £C 43.2 million and to £C 48 million, respectively. The deficit on investment income increased slightly due to rising interest payments on the public foreign debt in particular, while the deficit on account of freight and insurance continued to widen, as imports were increasing. The increase in net revenue from other services continued in 1980 when they increased by 20.5 per cent, compared with 17.3 per cent in 1979, but decelerated to 11.9 per cent in 1981, largely because of deceleration in emigrants' and workers' remittances.

Tax incentives for offshore companies were introduced in 1975 at the time civil war broke out in Lebanon, and Beirut could no longer preserve its dominant role as a service center for the Middle East. By mid-August 1981 the number of companies licensed reached 1,060, not including about 4,000 nonresident shipping companies which operate under the Cyprus flag. What little data are available indicate that direct and indirect revenues from these activities account for some £C 15 million a year. The Central Bank of Cyprus is now examining applications more closely, and the requirement of a minimum capital of £C 10,000, or adequate bank references was introduced. Also, the Central Bank is preparing a policy on offshore banking units in order to attract banks with fully staffed operations.

The increase in service receipts in 1980 and 1981 was accompanied by a moderate rise in receipts from net private transfers while the net receipts from official transfers decreased slightly. Grants from the Greek Government consisted of 30.0 per cent of total transfer receipts. The remaining inflows comprised remittances by Cypriot emigrants and grants received from United Nations Organizations, such as United Nations High Commission for Refugees (UNHCR) and United Nations Development Program (UNDP).

5. Capital account

After a decrease of about £C 4 million in 1979, net capital inflow to Cyprus in 1980 and 1981 rose substantially to £C 79.2 million, and £C 95.5 million, respectively. This increase reflects mainly a substantial increase in official long-term loan receipts, especially for the financing of the budget deficit. After private long-term loans (including loans contracted by semipublic bodies) fell by about 58 per cent in 1979, they started to recover in 1980 by 93.9 per cent and continued to increase by 113.8 per cent in 1981.

Following a continuous increase, direct foreign investment, consisting mainly of direct investment by Cypriots living abroad, reached £C 30 million in 1980, a rate of growth of 20 per cent compared with 17.4 per cent in 1979. In 1981 they remained at the same level as in 1980. Partial data indicate that the majority of these investments are in real estate and tourism. However, the opening of the free industrial

zone at Larnaca, with space for about 100 factories, may encourage direct investment in manufacturing by taking advantage of the proximity to the booming markets in the Arab countries, and of the skilled work force and the good managerial abilities of the Cypriots.

Short-term capital, consisting mainly of trade credits, decreased in 1980 after a sharp rise in previous years, but recovered partly in 1981. The surplus on errors and omissions declined in 1980 to £C 5.2 million, equivalent to about one third of total private long-term loans. The high positive figure on errors and omissions during the last years may be explained mainly by underinvoicing of exports, underestimation of tourist receipts, and delays in official notification of suppliers' credits.

6. Official reserves and exchange rate

Official foreign reserves increased from SDR 284 million at end-December 1979, to SDR 305 million at end-December 1980, and to SDR 390 million at end-November 1981, mainly because of the rise in foreign borrowing (Table 38). However, in relation to merchandise imports, they continued to decrease from an amount equivalent to 4.3 months of imports in 1979 to 4.0 months worth in 1980. But they were at the level of 4.8 months worth at end-November 1981. At the same time, external debt service increased from the equivalent of 5.6 per cent of exports of goods and services in 1979 to 6.9 per cent in 1980 and to 8 per cent in 1981 (Table 39). During 1980, total external debt increased by £C 47.1 million to £C 208.8 million. In relation to GNP, this is an increase to 26.9 per cent, of which long-term debt equalled 23.7 per cent (Table 40). In 1981, total external debt increased further to £C 288 million, the equivalent of 32.8 per cent of GNP.

In 1973, it was decided to peg the Cyprus pound to a basket of currencies, which at present consists of the currencies of the 16 most important trading partners, weighted according to their trade share on the basis of 1975. The peg is mostly automatic, although discretion is used in special circumstances which could lead to unsettled market conditions. At present, about 75 per cent of total imports are represented in the basket, but on the export side only 54 per cent, mainly because the Arab currencies have not been given the share they deserve in the basket. In addition, the weighting system is based only on merchandise trade in spite of the importance of services for Cyprus.

Since 1973, the exchange rate for the Cyprus pound has been adjusted daily on the basis of the previous day's London rate, in order to maintain its average relationship with the currencies of its main trading partners. The Central Bank of Cyprus is fixing daily buying and selling rates for the deutsche mark, the Greek drachma, the pound sterling, and the U.S. dollar. The Central Bank also offers authorized dealers facilities for forward purchases and sales of U.S. dollars and pound sterling for periods of up to six months, in respect of trade transactions only. In their exchange rate policy, the authorities have paid greater importance to imports because of their impact on the consumer prices and the high import content

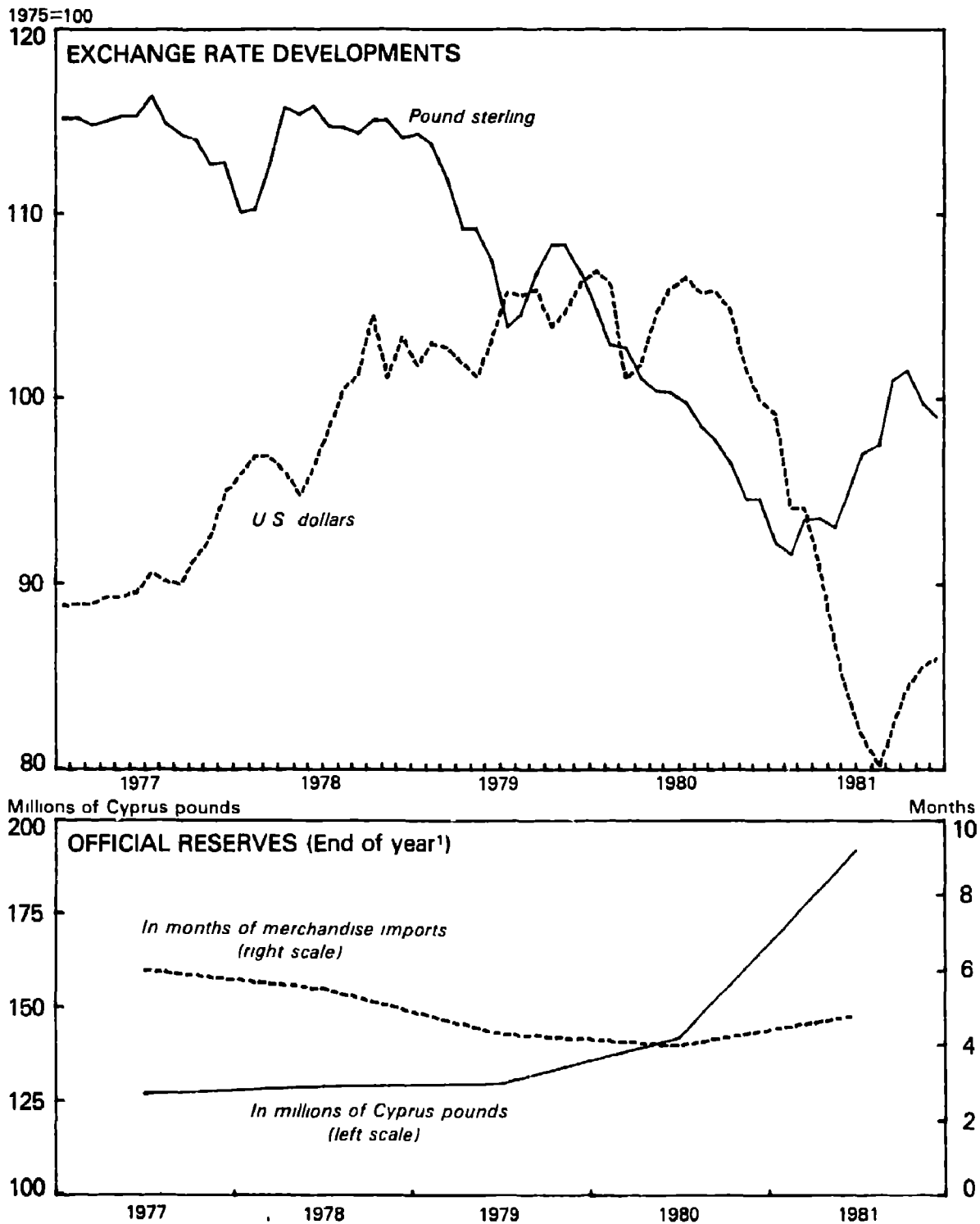
in exports. They considered also, that most of the exports in the short run are not affected by changes in exchange rate (except the manufactured exports) as the exports are sent abroad on consignment, waiting for the best prices.

During 1980 the exchange rate of the Cyprus pound continued to appreciate against the U.S. dollar, but only by 0.4 per cent compared with 5 per cent in 1979 (Chart 10). At the same time, the Cyprus pound continued to depreciate against the pound sterling by 9.2 per cent compared with 5.0 per cent in 1979 and against the deutsche mark, but continued to appreciate against the Greek drachma. However, during the first 11 months of 1981 the exchange rate of the Cyprus pound depreciated on average against the U.S. dollar by 16.3 per cent, compared with the same period of the previous year. The effective exchange rate, as calculated by the Fund staff, continued to appreciate during 1980 at the same rate of 1.2 per cent as in 1979. During the first 11 months of 1981 the effective exchange rate appreciated on average by an additional 2.2 per cent, compared with the same period of 1980. But according to tentative calculations of the Central Bank of Cyprus, using a basket with 27 currencies, the effective exchange rate for the Cyprus pound, after a moderate effective appreciation during the period 1976-79, appreciated slightly in 1980, and depreciated somewhat in the first half of 1981.

CHART 10

CYPRUS

EXCHANGE RATES AND RESERVES



Source: IMF International Financial Statistics, Central Bank of Cyprus Bulletin

¹ For 1981, the data are for the end of the third quarter

Table 30 Cyprus Balance of Payments Summary, 1976-81

(In millions of Cyprus pounds)

	1976	1977	1978	1979	1980	1981 ^{1/}	1979	1980	1981
Exports, f o b	102.7	124.2	122.0	149.5	172.7	208.5	77.0	86.1	106.9
Imports, f o b	-163.3	-228.1	-255.4	-321.2	-381.0	-436.5	-145.8	-200.1	-215.8
Trade balance	-60.6	-103.9	-133.4	-171.7	-208.3	-228.0	-68.8	-114.0	-108.9
Invisible receipts	112.1	137.5	150.4	195.1	241.9	290.3	82.0	108.6	131.1
Of which: travel receipts	20.7	23.8	33.3	50.1	70.5	96.0	17.4	26.7	43.8
Invisible payments	55.7	-69.5	-75.6	-96.0	-114.5	-137.6	-41.4	-53.8	-61.3
Invisible balance	56.4	68.0	74.8	99.1	127.4	152.7	40.6	54.8	67.5
Current account balance	-4.2	-35.9	-58.6	-72.6	-80.9	-75.3	-28.2	-59.2	-41.4
Direct investment	13.3	16.9	21.3	25.0	30.0	30.0	12.5	15.0	15.0
Private long-term loans	2.8	2.1	19.6	8.2	15.9	34.0	3.9	2.5	13.4
Official long-term loans	9.6	15.8	12.9	12.0	31.3	26.5	8.3	4.8	26.5
Short-term capital	-5.2	0.9	3.2	8.6	2.0	5.0	3.5	3.1	-1.1
Capital balance	20.5	35.7	57.0	53.8	79.2	95.5	26.2	25.4	26.4
Net errors and omissions	1.5	2.4	5.5	7.4	5.2	-2.2	1.8	3.9	2.5
Overall balance	17.8	2.2	3.9	-11.4	3.5	18.0	1.8	-13.2	-12.5
Memorandum items									
Current account balance/GDP	-1.3	-8.5	-11.5	-11.5	-10.8	-8.7	-9.3	-13.6	-5.7
Merchandise exports/GDP	31.3	29.4	24.0	23.8	23.0	24.2	25.5	23.5	22.6
Merchandise imports/GDP	49.8	54.1	50.2	51.1	50.8	50.8	48.2	53.8	47.1

Source: Central Bank of Cyprus, Bulletin, and data provided by the Cypriot authorities

1/ Official estimates based on developments through the first half of the year

Table 31 Cyprus Balance of Payments, 1973-81

(In millions of SDRs) 1/

	1973	1975	1976	1977	1978	1979	1980		1981	
							I	II	I	II
1 Trade balance										
Exports, f o b	-199 0	-130 9	-127 9	-218 1	-285 5	-375 1	-248 7	-204 9	-224 9	-232 9
Imports, f o b	137 3	117 2	216 8	260 7	261 1	326 7	187 8	188 2	220 7	198 6
	-337 2	-248 1	-344 7	-478 8	-546 6	-701 8	-436 5	-393 1	-445 6	-431 5
2 Net services	119 8	40 7	66 5	80 4	106 2	161 0	92 9	128 0	114 0	139 6
Revenue	219 4	130 6	181 3	223 6	265 4	367 7	208 8	258 4	243 9	282 9
Of which										
Travel	57 1	12 1	43 7	50 0	71 3	109 5	58 2	95 2	78 5	113 4
Military transactions	97 2	62 2	59 5	68 9	66 1	81 9	45 6	48 5	50 0	46 5
Expenditure	-99 6	-89 9	-114 8	-143 2	-159 2	-206 7	-115 9	-130 4	-129 9	-143 3
3 Private transfers	10 1	12 5	11 4	12 2	18 0	19 7	12 2	12 8	12 8	13 1
4. Balance on goods, services, and private transfers (1+2+3)	-70 0	-77 7	-50 0	-125 5	-161 3	-194 4	-143 6	-64 1	-98 1	-80 2
5 Official transfers	2 4	47 0	41 2	50 1	35 9	35 8	14 4	16 9	12 6	13 9
6 Current account (4+5)	-67 6	-30 7	-8 8	-75 4	-125 4	-158 6	-129 2	-47 2	-85 5	-66 3
7. Nonmonetary capital										
Direct investment	56 8	-1 3	46 2	80 1	133 8	133 7	29 3	55 1	28 9	64 4
Private long-term loans	31 2	8 5	28 1	35 5	45 6	54 6	15 0	15 0	15 0	15 0
Government	3 8	-2 7	5 9	4 4	42 0	17 9	2 5	9 4	17 4	16 0
Private short-term loans 2/	5 0	4 5	20 2	33 1	27 6	26 2	4 8	27 3	--	26 5
Change in monetary capital 3/	16 8	-11 6	-8 0	7 1	18 6	35 0	7 0	3 8	-3 5	6 3
8 Change in reserves and related items 4/	-1 4	5 8	2 3	16 7	6 8	15 7	5 0	16 7	10 9	18 4
9 Change in reserves and related items 4/	12 2	26 2	-39 7	-21 4	-15 2	9 2	60 2	-89 3	14 9	-78 0
Use of IMF credit 5/	--	1 7	35 0	--	-16 5	5 9	-0 3	-1 0	--	--
Foreign exchange, SDRs, and Monetary gold	12 2	24 5	-74 7	-21 4	1 3	3 3	60 5	-88 3	14 9	-78 0

Sources Central Bank of Cyprus, Bulletin Data provided by the Cypriot authorities, and IMF, International Financial Statistics

1/ Conversion factors (to SDR 1) 1973, 0 41665, 1975, 0 44700, 1976, 0 47373, 1977, 0 47634, 1978, 0 46722, 1979, 0 45769, 1980, first half, 0 45838, and second half, 0 46022, and 1981, first half, 0 48431, and second half, 0 51152

2/ Including net errors and omissions

3/ Including nonresident deposits with commercial banks, commercial banks' foreign balances and securities, and balances under bilateral payments agreements

4/ Minus sign denotes increase in assets or decrease in liabilities

5/ Including reserve position in the Fund

6/ Official estimates based on developments through the first half of the year

Table 32. Cyprus: Volume and Prices of Exports and Imports

(1973 = 100)

	Volume of Exports <u>1/</u> (1)	Volume of Imports (2)	Export Prices <u>1/</u> (3)	Import Prices (4)	Terms of Trade (3)/(4) (5)
1974	79.1	70.1	114.6	134.1	85.5
1975	70.1	48.8	135.3	148.0	91.4
1976	114.8	75.0	143.8	150.7	95.4
1977	146.8	101.8	144.7	158.6	91.2
1978	138.6	112.7	144.8	159.4	90.8
1979	160.1	128.7	155.0	176.5	87.8
1980	171.5	133.5	168.3	201.9	83.4
1981 <u>4/</u>	186.9	136.2	186.0	225.9	82.3

(Percentage changes) 2/

Annual average

1970-73 <u>3/</u>	5.1	11.7	3.5	4.7	...
1973	7.5	21.3	7.3	7.3	--
1974	-20.9	-29.9	14.6	34.1	-14.5
1975	-11.4	-30.4	18.1	10.4	6.9
1976	63.8	53.7	6.3	1.8	4.4
1977	27.9	35.7	0.6	5.2	-4.4
1978	-5.6	10.7	0.1	0.5	0.4
1979	15.5	14.2	7.0	10.7	-3.3
1980	7.1	3.7	8.6	14.4	-5.0
1981 <u>4/</u>	9.0	2.0	10.5	11.9	-1.3

Sources: Central Bank of Cyprus, Bulletin. Data provided by the Cypriot authorities; and Ministry of Finance, Imports and Exports Statistics.

1/ Excluding re-exports and stores for ships and aircraft.

2/ Over the previous year.

3/ Annual average.

4/ Official estimates based on developments through the first half of the year.

Table 33. Cyprus: Commodity Composition of Exports and Imports, 1973-81

	1977	1978	1979	1980	1981 First Half	1977	1978	1979	1980	1981 First Half	1978	1979	1980	1981 First Half	Percentage change over preceding year, or over corresponding period of the previous year
	In per cent of total					In millions of Cyprus pounds									
Total domestic exports 1/	100.0	100.0	100.0	100.0	100.0	109.5	103.6	127.6	148.5	97.5	-5.4	23.2	16.4	29.6	
Food and live animals	37.9	31.7	31.7	27.8	35.4	41.5	32.8	40.5	41.3	34.5	-21.0	23.5	2.0	42.8	
Citrus	6.0	6.5	7.0	5.5	6.5	6.6	6.7	8.9	8.2	6.3	1.5	32.8	-7.9	37.0	
Potatoes	17.7	10.4	10.7	8.6	18.5	19.4	10.8	13.6	12.7	18.0	-44.3	25.9	-6.6	53.8	
Beverages and tobacco	11.6	13.4	11.2	10.6	9.2	12.7	13.9	14.3	15.7	9.0	9.4	2.9	9.8	17.9	
Chemicals	3.6	2.4	1.5	2.8	3.1	3.9	2.5	1.9	4.1	3.0	35.9	-24.0	115.8	57.9	
Minerals 2/	7.9	6.8	6.7	5.4	4.0	8.7	7.0	8.5	8.0	3.9	-19.5	21.4	-5.9	-10.8	
Copper concentrates	1.7	1.4	0.8	0.1	--	1.9	1.5	1.0	0.1	--	21.1	-33.3	-90.0	--	
Asbestos	4.0	3.6	4.1	3.1	2.5	4.4	3.7	5.2	4.6	2.4	-15.9	40.5	-11.5	142.8	
Manufactures	37.4	43.6	46.8	50.9	45.2	41.0	45.2	59.7	75.6	44.1	10.2	32.1	26.6	26.0	
Clothing	11.0	15.7	17.3	18.9	17.8	12.0	16.3	22.1	27.9	17.4	35.8	35.6	26.2	39.2	
Footwear	5.5	6.9	6.5	7.9	9.1	6.0	7.1	8.3	11.7	8.9	18.3	16.9	40.0	56.1	
Portland cement	9.7	8.0	8.1	8.7	2.7	10.6	8.3	10.3	12.9	2.6	-21.7	24.1	25.2	-53.6	
Other	1.6	2.1	2.1	2.6	3.1	1.7	2.2	2.7	3.8	3.0	29.4	22.7	40.7	52.0	
Total imports, c.i.f. 3/	100.0	100.0	100.0	100.0	100.0	254.0	282.7	357.6	424.3	240.5	11.3	26.5	18.7	7.9	
Consumer goods	19.4	19.9	19.0	18.8	17.9	49.3	56.2	67.8	79.6	43.1	14.0	20.6	17.4	-1.4	
Intermediate inputs	45.3	43.4	48.2	43.7	44.2	115.2	122.7	172.4	185.3	106.2	6.5	40.1	7.5	22.9	
Capital goods	12.4	12.2	11.0	9	8.3	31.6	34.4	39.2	40.9	21.1	8.9	14.0	4.3	-21.9	
Manufacturing	6.5	5.8	4.2	3.0	2.4	16.6	16.4	15.1	17.0	8.1	-1.2	-7.9	12.6	-36.2	
Construction and mining	1.3	2.1	1.9	1.3	1.3	3.4	5.8	6.8	6.2	3.7	7.1	17.2	-8.8	15.6	
Transport equipment	8.5	12.2	9.1	7.3	7.4	21.5	36.5	32.7	39.7	17.9	69.8	-10.4	21.4	-18.3	
Fuel and lubricants	13.9	11.0	12.4	12.1	11.2	35.2	31.0	44.5	78.5	52.0	-11.9	43.5	76.4	19.0	
Unclassified	0.5	0.6	0.3	0.1	0.1	1.2	1.9	1.0	0.3	0.2	58.3	-47.4	-70.0	33.1	

Sources: Central Bank of Cyprus, Bulletin; and Ministry of Finance, Imports and Exports Statistics.

1/ Excluding stores for ships and aircraft.

2/ Including quarrying materials.

3/ Excluding imports by foreign embassies and military bases.

Table 34. Cyprus: Merchandise Trade, 1973-81

(Customs data)

	Domestic		Re-exports ^{2/}		Total Exports, f.o.b.		Imports, c.i.f. ^{3/}		Trade Deficit ^{4/}	
	Exports, f.o.b. ^{1/}	Percentage change 5/	In millions of fC	Percentage change 5/	In millions of fC	Percentage change 5/	In millions of fC	Percentage change 5/	In millions of fC	Percentage change 5/
1969-73 6/	43.0	9.0	6.1	10.0	49.1	10.0	115.6	17.0	-66.5	
1973	51.4	15.0	9.1	18.0	60.5	18.0	158.9	29.0	-98.4	
1976	85.7	75.0	20.6	90.0	106.3	90.0	178.7	56.0	-72.4	
1977	111.2	30.1	18.6	22.0	129.8	22.0	255.0	43.0	-125.2	
1978	106.4	-4.3	22.0	-1.0	128.4	-1.0	283.8	11.0	-155.4	
1979	135.2	27.1	26.7	26.0	161.9	26.0	361.1	27.0	-199.2	
1980	157.0	16.1	31.0	16.1	188.0	16.1	428.3	18.6	-240.3	
I	30.6	7.7	8.2	14.2	38.8	14.2	107.9	46.4	-69.1	
II	47.0	13.8	6.8	10.4	53.9	10.4	116.8	29.9	-63.0	
III	40.4	25.1	8.5	24.7	48.9	24.7	100.7	8.3	-51.8	
IV	38.5	19.9	7.5	16.5	46.0	16.5	102.9	-1.5	-56.4	
1981										
I	38.1	24.5	6.3	14.4	44.4	14.4	124.0	14.9	-79.6	
II	62.3	32.6	8.3	32.3	71.3	32.3	117.3	8.7	-46.0	

Sources: Central Bank of Cyprus, Bulletin; and Ministry of Finance, Imports and Exports Statistics.

1/ Excluding re-exports, but including domestic stores for ships and aircraft.

2/ Including foreign stores for ships and aircraft.

3/ Including imports (of two-four million per year) by foreign embassies and military bases.

4/ Total exports, f.o.b., less imports, c.i.f.

5/ Over preceding year, or over the same period in the previous year.

6/ Annual average.

Table 35. Cyprus: Regional Development of Foreign Trade, 1973-81

	Exports 1/										Exports 2/									
	1980	1981	1973	1976	1977	1978	1979	1980	1981	First half	1980	1981	1973	1976	1977	1978	1979	1980	1981	
	In millions of £C										In per cent of total imports									
	In per cent of total exports																			
United Kingdom	39.0	30.0	39.9	27.7	28.7	23.4	25.4	20.8	25.9		65.5	34.9	24.9	19.7	19.0	22.1	16.9	15.4	14.5	
Other EC	14.0	9.0	20.3	5.4	5.4	7.7	7.2	7.4	7.8		119.0	64.4	30.3	28.0	27.5	28.7	30.3	28.0	26.8	
Oil-exporting countries 3/	50.1	33.4	4.8	18.7	24.0	24.1	21.7	25.3	28.9		47.8	28.9	4.4	8.4	6.9	6.3	6.7	11.2	12.0	
Lebanon	18.7	7.0	1.9	16.9	9.2	10.1	9.3	9.9	6.1		0.7	0.2	0.9	0.6	0.4	0.4	0.3	0.2	0.1	
Other Middle Eastern countries 4/	19.3	10.1	2.4	8.8	9.2	11.5	11.6	11.8	8.7		5.0	5.0	2.2	2.3	2.4	2.0	2.0	2.4	2.1	
CMEA countries	11.1	7.7	14.7	8.1	5.7	5.8	5.2	5.9	6.7		31.7	17.6	6.5	6.8	8.2	7.0	7.3	7.5	7.3	
Greece	4.8	2.6	3.2	2.1	2.9	2.8	2.5	2.6	2.2		29.8	16.9	5.7	9.8	8.3	6.3	7.5	7.0	7.0	
United States	2.5	1.1	1.2	0.5	0.8	1.5	1.4	1.3	0.9		25.3	18.7	6.7	5.5	5.6	5.6	5.5	6.0	7.8	
Rest of the world	28.5	14.8	11.6	11.8	14.1	13.1	15.7	15.0	12.8		99.5	53.8	18.4	18.9	21.7	21.6	23.5	22.3	22.4	
Total	188.0	115.7	100.0	100.0	100.0	100.0	100.0	100.0	100.0		424.3	240.4	100.0	100.0	100.0	100.0	100.0	100.0	100.0	

Source: Ministry of Finance, Imports and Exports Statistics.

^{1/} Including re-exports.^{2/} Excluding imports by foreign embassies and military bases.^{3/} Excluding Nigeria.^{4/} Excluding Yemen Arab Republic and People's Democratic Republic of Yemen.

Table 36. Cyprus: Indicators of Export Performance

(Annual percentage change)

	1976	1977	1978	1979	1980	1981 ^{3/}
Market growth ^{1/}	10.1	6.8	5.7	4.5	4.3	6.0
Export growth ^{2/}	63.8	27.9	-5.6	15.5	7.1	9.0
Market share	48.8	19.8	-10.7	10.5	2.7	2.8
<u>Memorandum items:</u>						
Tourist arrivals	282.6	-1.1	21.6	37.1	19.0	19.0
Exchange rate (U.S. dollars per Cyprus pound)	-10.3	0.6	9.3	5.3	0.4	-15.6

Sources: Central Bank of Cyprus, Bulletin. Data provided by the Cypriot authorities; and IMF, Data Fund and World Trade Model.

^{1/} For Cyprus exports. Calculated on the basis of the movement in import volumes of Cyprus's major trading partners.

^{2/} Excluding re-exports and stores for ships and aircraft.

^{3/} Official estimates based on developments through the first half of the year.

Table 37. Cyprus: Invisible Transactions, 1976-81

(In millions of Cyprus pounds)

	1976	1977	1978	1979	1980	1979		1980		1981	
						I	II	I	II	I	II
Freight and insurance	-13.9	-20.8	-22.1	-29.6	-35.8	-13.1	-16.5	-18.9	-16.9	-20.6	21.1
Receipts	3.8	4.5	5.0	5.7	6.3	2.8	2.9	3.1	3.2	3.4	3.4
Payments	-17.7	-25.3	-27.1	-35.3	-42.1	-15.9	-19.4	-22.0	-20.1	-24.0	24.5
Other transportation, net	-1.0	1.8	4.3	11.0	17.8	5.4	5.6	8.5	9.3	10.8	14.3
Travel	11.0	12.0	19.5	34.1	50.7	10.7	23.4	18.6	32.1	28.4	44.6
Receipts	20.7	23.8	33.3	50.1	70.5	17.4	32.7	26.7	43.8	38.0	58.0
Payments	-9.7	-11.8	-13.8	-16.0	-19.8	-6.7	-9.3	-8.1	-11.7	-9.6	-13.4
Investment income, net	-2.4	-4.0	-3.8	-3.7	-3.8	-1.7	-2.0	-2.0	-1.8	-4.2	-6.9
Military transactions	28.2	32.8	30.9	37.5	43.2	16.4	21.1	20.9	22.3	24.2	23.6
Other services, net	9.6	16.5	20.8	24.4	29.4	10.7	13.7	15.5	13.9	16.6	16.7
Total services	31.5	38.3	49.6	73.7	101.5	28.4	45.3	42.6	58.9	55.2	71.4
Private transfers, net	5.4	5.8	8.4	9.0	11.5	4.6	4.4	5.6	5.9	6.2	6.7
Services and private transfers	36.9	44.1	58.0	82.7	113.0	33.0	49.7	48.2	64.8	61.4	78.1
Government transfers, net	19.5	23.9	16.8	16.4	14.4	7.6	8.8	6.6	7.8	6.1	7.1
Total invisible surplus	56.4	68.0	74.8	99.1	127.4	40.6	58.5	54.8	72.6	67.5	85.2
Memorandum item ¹											
Travel receipts/Merchandise exports	20.2	19.2	27.3	33.5	40.8	22.6	45.1	31.0	50.6	35.5	57.1

Sources. Central Bank of Cyprus, Bulletin, and data provided by the Cypriot authorities.

1/ Official estimates based on developments through the first half of the year.

Table 38. Cyprus: Official Reserves, 1973-81

(In millions of SDRs; end of period)

	1973	1974	1975	1976	1977	1978	1979	1980				1981		
								I	II	III	IV	I	II	III Nov.
Gold 1/	15	15	15	15	15	16	16	16	16	16	16	16	16	16
SDRs	10	10	10	5	5	2	10	12	8	15	7	9	4	1
Reserve position in the Fund	7	--	--	--	--	6	6	6	--	--	--	--	--	--
Foreign exchange	222	194	159	228	254	257	252	201	198	225	282	237	264	374
Total	254	219	184	251	274	281	284	235	222	256	305	262	284	390
(In millions of Cyprus pounds)	108	97	84	119	127	129	130	109	102	118	142	125	143	197

Source: IMF, International Financial Statistics; and Central Bank of Cyprus, Bulletin.

1/ Gold at SDR 35 per ounce. The Central Bank of Cyprus values gold at the cost of acquisition, and most of the gold was acquired at SDR 35 per ounce.

Table 39. Cyprus: External Debt Service, 1/ 1973-83

	<u>Government</u>	<u>Other^{2/}</u>	<u>Total</u>	<u>Total</u>
	In millions of Cyprus pounds			In per cent of exports of goods and services
<hr/>				
Actual				
1973	0.4	3.7	4.1	2.8
1974	0.6	3.1	3.7	2.8
1975	0.8	3.4	4.2	3.8
1976	1.4	5.4	6.8	3.6
1977	2.6	6.1	8.7	3.8
1978	3.7	7.3	11.0	4.5
1979	5.8	12.1	17.9	5.6
1980	10.2	16.6	26.8	6.9
On debt outstanding at end-1980				
1981 <u>3/</u>	17.3	20.6	37.9	8.0
1982 <u>3/</u>	27.4	25.6	53.0	9.6
1983 <u>3/</u>	33.7	25.0	58.7	9.4

Source: Data provided by the Cypriot authorities.

1/ Principal and interest payments on long-term debt excluding payments to the IMF.

2/ Including public corporations.

3/ Official estimates.

Table 40. Cyprus: External Debt, 1/ 1973-81
(In millions of Cyprus pounds; end of period)

	1973	1975	1976	1977	1978	1979	1980	1981 2/
Total external	45.2	59.6	83.5	108.1	133.7	161.1	208.8	288.0
Long-term 1/	24.3	36.3	65.8	89.5	112.8	136.4	183.6	259.0
Short-term	20.9	23.3	17.7	18.6	20.9	24.7	25.2	29.0
By debtor								
Government	6.8	14.4	42.5	58.1	67.4	81.1	109.8	144.9
Long-term 1/	6.8	14.4	42.5	58.1	67.4	81.1	109.8	144.9
Short-term	--	--	--	--	--	--	--	--
Public corporations	16.9	22.2	19.1	24.2	34.9	40.5	48.0	82.5
Long-term	13.3	17.8	19.1	24.2	34.9	40.5	48.0	82.5
Short-term	3.6	4.4	--	--	--	--	--	--
Suppliers' credits	18.9	20.8	19.2	20.1	22.6	27.3	27.3	31.0
Long-term	1.6	1.9	1.5	1.5	1.7	2.6	2.1	2.0
Short-term	17.3	18.9	17.7	18.6	20.9	24.7	25.2	29.0
Other	2.6	2.2	2.7	5.7	8.8	12.2	23.7	29.6
Long-term	2.6	2.2	2.7	5.7	8.8	12.2	23.7	29.6
Short-term	--	--	--	--	--	--	--	--
By creditor								
International organizations	11.6	22.6	50.5	52.4	53.1	59.0	62.1	73.3
Governments	3.8	4.2	5.7	8.4	10.8	12.0	11.8	14.2
Other	29.8	32.8	27.3	47.3	69.6	90.1	134.9	200.5
Memorandum items:								
(in percent of GNP)								
Total external debt	13.0	22.3	24.4	24.5	25.3	24.8	26.9	32.8
Long-term	7.0	13.6	19.3	20.3	21.3	21.0	23.7	29.5
Short-term	6.0	8.7	5.1	4.1	3.9	3.8	3.3	3.3

Source: Data provided by the Cypriot authorities.

1/ Includes borrowing from IMF.

2/ Official estimates.

V. Exchange and Trade System

In September 1981 Cyprus terminated its last remaining bilateral payments agreement, namely that with the People's Republic of China. A detailed survey of Cyprus' exchange and trade system up to December 1980 is contained in the Annual Report on Exchange Arrangements and Exchange Restrictions, 1981. A summary of the present system and changes undertaken in 1980 and so far in 1981 is set out below. A description of the exchange rate system and exchange rate developments is contained in Chapter V, Section 5.

1. Exchange system

Exchange controls are administered by the Central Bank. Authorized dealers approve applications for the allocation of foreign exchange within the scope of instructions issued by the Central Bank. Commercial transactions and invisibles may be settled in any foreign currency, or by crediting/debiting Cyprus pounds to/from an external account.

Nonresidents may maintain with authorized banks external accounts or foreign currency accounts, which can be credited with authorized payments from residents of Cyprus, with transfers from other external accounts or foreign currency accounts, and with the proceeds from sales by nonresidents of foreign currency. From these accounts, nonresidents can pay to residents, and nonresidents can transfer to other similar accounts and can purchase any foreign currency. However, the delivery of foreign currency notes to nonresidents in Cyprus against external accounts or foreign currency accounts is prohibited with specific exceptions. Blocked funds of a capital nature, invested as deposits or invested in government securities or government-guaranteed securities, are held in blocked accounts maintained in the name of a nonresident. Income earned on these investments may be remitted to the nonresident or be credited to an external account. Blocked funds can be released on application in certain specified circumstances. In addition, the Central Bank is prepared to permit the release of blocked funds to each nonresident holder up to £C 1,000 in any calendar year.

Payments for invisibles require the approval of the exchange control authorities. Profits, dividends, and interest from approved foreign investments may be transferred abroad without restriction. Certain categories of payments, especially allowances for travel and study, are limited, to prevent illegal capital outflows. On January 1, 1982 the authorities raised the annual basic travel allowance from £C 300 to £C 350 per person, which is the level prevailing prior to mid-1974; in exceptional circumstances, amounts in excess of the basic allowance may be obtained. Residents have also the right to a business travel allowance of up to £C 100 per day. The necessity to maintain travel restrictions was argued on the grounds of the unsettled political situation, the uncertainties surrounding the balance of payments, and the possibility of illegal capital outflows. All the same, tourist expenditure substantially increased within

the present framework as the number of Cypriot tourists rose from 46,000 in 1963 to 62,000 in 1980. Residents also have a right to an allowance for expenses on education abroad which was raised in 1981 from £C 1,300-£C 2,100 to £C 1,450-£C 2,700 per person for a year, plus an additional allowance for payment of tuition.

Payments abroad of a capital nature require prior approval, and capital receipts in foreign currencies must be sold to an authorized dealer. Outward portfolio investment is not normally permitted, and only specified types of outward direct investment (e.g., for export promotion) are approved. Nonresidents may apply for approval of their direct investment in Cyprus. In considering applications, exchange control authorities analyze the purpose of the investment, the extent of possible foreign exchange savings, the number of persons to be employed, the extent of the foreign exchange liability which might arise from the investment, and possible competition with existing industries. Proceeds from liquidation of approved foreign investments may be repatriated in full without restrictions, after payment of charges and taxes due. The transfer abroad of funds from estates and the proceeds of real estate sales is limited to £C 1,000, with any excess amount to be credited to a blocked account. Residents of Cyprus who take up residence outside the country may transfer abroad up to £C 5,000. Any excess amount is to be deposited in a blocked account.

2. Trade system and commercial policy

Trade controls are administered by the Ministry of Commerce and Industry. Imports of virtually all commodities may be purchased freely from all countries other than South Africa (from which imports are prohibited), Albania, Bulgaria, the People's Republic of China, Czechoslovakia, the German Democratic Republic, Hungary, the Democratic People's Republic of Korea, Poland, Romania, and Vietnam, for which import licenses are required. For protective reasons, certain goods (some agricultural and textile products, footwear, metal manufactures, and industrial machinery) may not be imported freely; for a few of these items no licenses are granted, while for most of them licenses are granted liberally. All in all, about 5 per cent of imports require a license.

In May 1980, the surcharge levied ad valorem on all imports with the exception of food, feedstuff, pharmaceuticals, and all goods imported by the central and local governments was increased from 2 per cent to 3.5 per cent. In addition, import duties on a wide range of goods considered as luxury or nonessential (alcoholic beverages, tobacco, air-conditioning units, hunting guns) were increased.

On November 1, 1980 exchanges and trade restrictions applying to Zimbabwe (formerly Rhodesia) were lifted.

All exports are subject to licensing when the f.o.b. value exceeds £C 100 to ensure registration of the sale proceeds, which must be surrendered without delay. Authority to introduce, adopt, and supervise control on exports of potatoes has been delegated to the Cyprus Potato Marketing Board,

while exports of wheat and barley are licensed by the Cyprus Grain Commission. Exports of cement are subject to a license for the purpose of ensuring adequate domestic supply.

3. Relations with the European Community

On December 1972 Cyprus signed a two-phase association agreement with the EC. The first phase came into effect in June 1973 and originally was supposed to end by June 1977, but has been extended through a series of temporary protocols until the end of 1981. The second phase of the Cyprus-EC agreement--involving the creation of a customs union--is likely to be delayed until 1984. According to the first stage of the agreement, the EC lifted all quantitative restrictions and reduced tariffs by 70 per cent on all industrial imports from Cyprus. Also, the EC reduced tariffs by 40 per cent to 100 per cent on certain agricultural imports from Cyprus. For its part, Cyprus reduced the custom tariffs by 35 per cent for most imports from the EC. On July 1, 1978, the EC lifted the custom tariffs on all industrial products from Cyprus. On the same date, Cyprus reduced by 20 per cent the tariffs on products that had no tariff concessions.

On May 11, 1978, two Cyprus-EC protocols were signed providing for additional tariff concessions on Cyprus' agricultural exports to the EC until the end of 1979. The first protocol granted concessions under the EC's overall Mediterranean policy, while the second took into account Cyprus' special difficulties following the ending of Commonwealth preference treatment in the U.K. market in 1977.

In 1979, Cyprus agreed to restrain its exports of textiles (T-shirts, trousers, blouses, shirts, dresses, and work clothes) to the U.K. market during 1979/80. At the same time, a financial protocol was signed providing for economic aid to Cyprus in the amount of ECU 30 million (some US\$38 million) to be granted until 1983 for the financing of electricity, irrigation, and sewage projects.

On January 1981 an agreement with the EC was reached concerning the terms of relations in 1981, which are the same as those for 1980 except for small adjustments. The Cypriot authorities consider that the terms for agricultural export to the EC are not satisfactory. At present, terms for 1982-83 are being negotiated; Cyprus expects an improvement of the provisions for exports, especially potatoes, wine and citrus fruits. Also, in 1982 Cyprus and the EC will start negotiations to decide on the terms for the establishment of full customs union starting 1984.

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