

February 2, 1982 - 82/10

The Acting Chairman's Summing Up at the Conclusion  
of the 1981 Article IV Consultation with Cyprus  
Executive Board Meeting 82/11 - February 1, 1982

Directors commended the Cypriot authorities on the success thus far achieved with their stabilization policies in the areas of the balance of payments and inflation. It was noted, however, that that success was attributable to the combined effects of domestic credit restriction on the private sector, continued high private savings, and cyclical factors, as fiscal policy remained highly expansionary and manufacturing investment was sluggish following cuts in profits. Directors agreed on the need to continue credit restriction and on the related need of bringing the budget deficit under control, so as not to put in jeopardy the initial success of the stabilization program and the longer-run growth prospects of the economy or create a requirement for large additional foreign financing. Directors felt that in order to reduce the budget deficit the authorities would have both to cut expenditure and raise revenue. They considered it important that the authorities review their policy on transfers and subsidies, which had soared in recent years, and restrain wage and salary outlays; avenues to raise revenue and improve the efficiency of the tax system should also be explored.

Directors stressed the beneficial effects to be derived from an increase in the nonmonetary share of deficit financing. Directors argued that interest rates should be responsive to changing economic conditions and suggested that a positive real rate of interest in Cyprus was desirable as a means of encouraging a level of savings that would be conducive to investment and would contain private consumption. By allowing the Government to tap private savings, higher domestic interest rates would also dampen the rapid growth of government foreign borrowing and hence help ensure overall monetary restraint. It was also suggested that the authorities explore the possibility of broadening the use of the available range of monetary policy instruments in order, inter alia, to deal with pent-up liquidity. Directors, noting the authorities' position to keep the effective exchange rate roughly stable, felt that a situation where real wages and salaries outpassed productivity could not persist and that efforts were necessary to modify the mechanism of wage indexation.