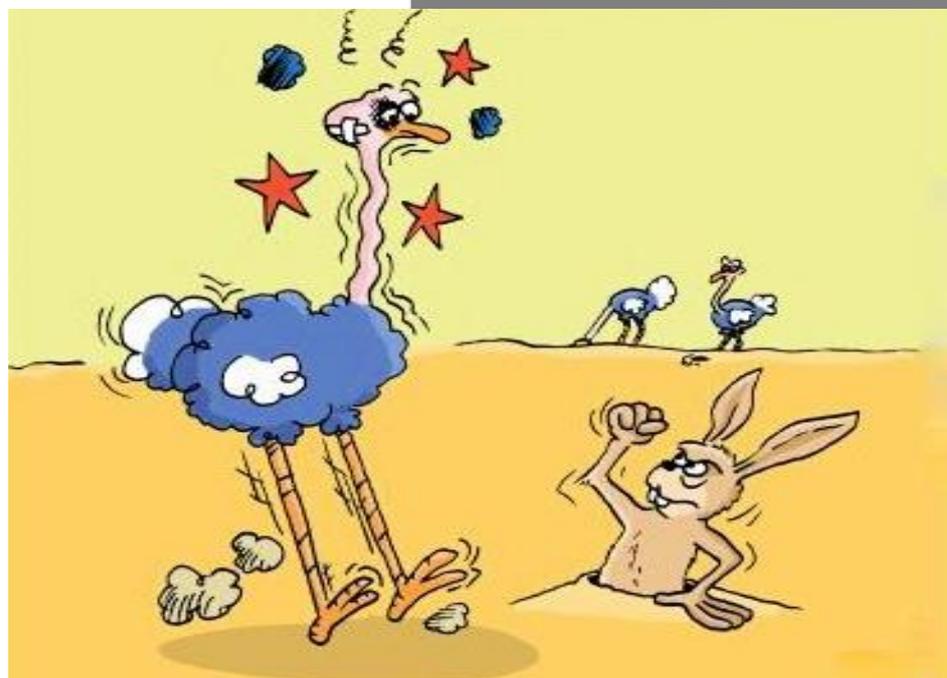


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Cyprus must change or suffer!



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Populist like and bigoted demagogic methods embraced by most political parties and trade unions alike, making use of popular prejudices and promises in order to gain power (or remain in power), preying on people's fears have to stop immediately!

Every day that goes by without the Cypriot government taking action to constructively remedy the economy is disastrous, tarnishing the reputation that Cyprus enjoyed for more than two decades (and worked for so hard) as a solid, reputable business hub and financial center!

It is clear that the recent downgrades by both S&P and Moody's are not taken seriously by the Cyprus Government as their only worry and consideration for action is related to the outcome of the coming elections... Shame to the Government but also to all political parties and trade unions whose public declarations and mumbling are gutless, confusing, mediocre and unworthy of whatever they claim to be!

These are times when every cent counts, that is, every cent that one spends, saves or invests. In times like these, advantages that a country like Cyprus offers, (i.e., strong and applicable legislation and sound regulatory system, the lowest corporate tax within the European Union and double-tax-treaty agreements with about 50 countries), should have been attracting investments or should have been encouraging even the most hesitant investor, individual or corporate, to invest in the Island. Instead, Cyprus is downgraded, Cyprus is exposed, Cyprus is not able to convince that it can respond to market dynamics promptly and responsively, worse, Cyprus cannot convince that it can manage its own. How can then Cyprus expect to attract investors? How can a potential investor be convinced that this Country is sound enough to "entrust" her/his wealth or savings?

Lack of vision and sciolism... populism and demagogy, practiced devoutly by political and union leaders... apathy towards the conceptions or misconceptions, evaluations and devaluations that foreign influential nations and professional bodies maintain, estimate or guesstimate for Cyprus... weaken the very foundations of the Island's existence as a business hub and a financial center to say the least... Who would want to invest or live in a country that nurtures apathy like it was a virtue?

Cyprus like every other nation has to realize that it exists within a globalized environment characterized amongst other, by unforeseen exogenous-caused risks and increased volatility. Cyprus has to be ready at all times for the worse; it cannot be only seeking for ways to just get by. How will the recent socioeconomic problems of the nearby countries of MENA affect Cyprus? What if Saudi Arabia, the largest oil producer in the world is next? What if Greece will not be in a position to pay off its debts? What if other European partner nations (which are very likely to) follow the path of Greece? What if the U.S. falls into another recession (something that is more than very likely to happen)? What if Cyprus is forced by the EU to raise its corporation tax?

It is all about efficiency and excellence... and there is neither efficiency nor excellence when the leaders of a country are characterized by mediocrity! And mediocrity is contagious! It becomes a way of life and infects all levels and dimensions of a society. Mentality has to change and first the mentality of the Country's leaders...

If Cyprus is to prosper, it has to strive for excellence, it has to become competitive, and it has to accumulate capital. First and foremost by cutting unnecessary and primitive "non-logical axioms" such is the Cost of Living Allowance (COLA).

COLA has to be eliminated. It only results to large increases in real wages and deterioration in competitiveness of domestic companies, undermining flexibility and competitiveness as it impedes relative wage adjustments across companies and sectors in line with productivity differentials. It imparts inertia to the public sector wage bill, making it more difficult to reverse the excessive growth of public sector wages and salaries. If you add these to a policy (embraced by the governmental and semi-governmental sectors and most financial institutions) that is not based on merit and performance, where people get jobs for life despite their performance, and where trade unions (that are influential and pampered by each



and every government in power because of political cost and own benefits) influence management decisions... then you have a formula of self-destruction!

By linking wages to the Consumer Price Index rather than productivity, COLA undermines competitiveness and labor flexibility, in addition to exacerbating the level and persistence of price shocks. Moreover, downward wages stickiness resulting from the COLA may become an impediment to the economy's ability to respond to the current low-growth environment. In particular, in the presence of long-duration wage contracts the COLA constrains the markets' ability to correct an overshooting of wages that may result from too optimistic an outlook at the time of the contract's inception.

Additionally, the social security system has to be restructured. Surplus is currently about 4% of GDP as contributions by employers, workers and the government, exceed outlays. Over the next three to four decades pension outlays are projected to rise by some 10 percentage points as the system matures and demographic changes play out. Unless other area of government spending is curtailed, this would raise total government spending to more than 50% of GDP – a very high level that could be sustained only with a heavy increase of taxes.

A solution: Simply, incorporate the COLA into the basic salary and from that point of time onward base salary increases on merit and performance! In regard to the social security system, bring outlays more in line with contributions, through lower replacement rates and higher retirement age. Freeze salary increments for 2011 and 2012 and increase government employee contribution to pension fund to 4% in 2011 and 5% in 2012.

Corporate and personal income taxes have to remain intact. Income tax evasion should be handled but should not become a "psychosis" by establishing complex legislation and inspection – if procedures do not remain as simple as possible they will scare off investment and eliminate the entrepreneurial spirit that resurrected this country after the Turkish invasion of 1974. Recent studies imply that the size of the black economy in Cyprus cannot be more than 8.5%, one of the lowest in the EU. Given the high tax free income in Cyprus (and the skewness of income distribution) the majority of workers are below the income tax threshold.

A solution: A high tax free income can help not only to reduce tax evasion directly but to also limit the potential tax evaders amongst higher earners. Adoption of such policy will even make tax compliance measures less costly to implement.

Noteworthy, there has been plenty debate lately about tax evasion instead one of finding ways of how tax revenues should be best managed and best directed towards the ever much needed public services improvements.

Additional issues addressed epigrammatically. The banking, tourism and real estate industries have to be reinforced in each and every possible way! Incentives, especially for foreign investors but also for private local ones have to multiply. Prudential controls towards cooperative credit societies should become stricter. Procedures within the governmental machine at every level have to be streamlined and become more responsive. Double tax treaties with more countries are a priority and should be dealt as such. Trade unions should adopt an open-minded policy. More decisive steps need to be taken to eliminate delays related to the issuance of title deeds. Building coefficients in selected areas have to increase. Hospitality and tourism have to be upgraded and better promoted. International hotel chains should be targeted and "invited". Architectural monstrosity should be eliminated. Architectural uniformity in all areas has to become a way of life. Tradition and heritage has to be protected and better projected. The government should refrain from being involved in business; business should be undertaken only by the private sector – the recent under study project with Qatari Diar for instance should have been considered only on a BOT basis...

Moreover, rumors and proposals for a temporary or permanent hike in the corporate income tax rate, even by a fraction, are disastrous! Rumors and proposals for higher property taxes are disastrous! Rumors and proposals for burdening the banking sector with any form of taxation are disastrous! The current high interest rate regime is disastrous! Rumors and



proposals for lifting bank confidentiality to spot tax evaders are disastrous! The temporary reduction in tourism sector VAT rates if not extended is disastrous!

Closing, it is imperative that the Cyprus government and every Cypriot should realize that time is running out, that sacrifices need to be made, that it is not enough to just mend temporarily the current problems, that a spirit of collectiveness, pride and transparency must compliment every effort undertaken. If not, the next global financial tremor will bring devastating effects... Cyprus, a smaller country will be unable to react... and that is when suffering will become a way of Cypriot life!

It is not late!

See also other publications by Pytheas on Cyprus:

[Investing in Cyprus – An EU bridge to the world of business \(February 2011\)](#)

[Cyprus – The Economy calls for immediate action! \(December 2010\)](#)

[Cyprus – Real estate and construction industries optimistic despite the slowdown \(October 2010\)](#)

[The Cyprus real property market contracted... \(October 2009\)](#)

[Buying real property in Cyprus \(April 2009\)](#)

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