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Statement by the Hon. **TAKIS KLERIDES**,
Governor of the Bank for **CYPRUS**,
at the Joint Annual Discussion

Minister of Finance and Governor of the World Bank for Cyprus
Mr. Takis Klerides

It is an honor to address these Annual meetings of the Governors of the International Monetary Fund and the World Bank group.

Much has happened in the two years since the Prague meetings in terms of the world economic situation and in economic policies pursued by the Cyprus authorities. Since early 2001 the growth of world output and trade has recorded a marked slowdown. The September 11, 2001 terrorist attacks in the United States and their aftermath contributed to the deceleration in the growth of real economic activity, though in varying degrees in different economies. In countries which rely heavily on the activities and services hardest-hit by the September 11 events and their repercussions, namely, air transportation, tourism and insurance, growth has been curtailed severely over the last 12 months.

Indeed, Cyprus has experienced a sharp fall in the number of tourist arrivals over the last four quarters, although tourist revenue has not suffered to the same extent because of a higher average expenditure per tourist that in turn reflect efforts to promote quality tourism.

However, what is of major concern at present is that the robust economic recovery expected in the current half-year for the advanced economies is not materialising. There appears to be increasingly the prospect that there will be a prolonged global slowdown or a double-dip recession. Moreover, the fragile

global prospects at present are being clouded by the threat of military hostilities in Iraq and uncertainty over their economic consequences.

The response of the authorities in the G7 economies and in the major international financial institutions, including the IMF and the ECB, to the fading prospects of a global recovery seems to be to “wait and see” balancing off the need for further economic adjustment against the risks of output contraction and/or deflationary tendencies.

While the process of adjustment will need to be associated with a deepening of structural reforms in Europe and Japan, policy-makers have to guard against subdued demand that may lead to too much unemployment and excess capacity and/or deflation. The ECB and the Federal Reserve must stand ready to relax monetary policies, and greater flexibility in the conduct of fiscal policy in Europe and North America may be required.

Although, a number of developing countries have withstood the effects of the global downturn relatively successfully, their efforts at pursuing export-led growth strategies should not be derailed by protectionist measures in the developed countries. The commitment to global free trade made in Doha in November 2001 must be renewed. Advanced countries have to keep their markets open to access for and services of developing countries.

In terms of policies of the international community to assist with significant poverty reduction in the poorest countries Cyprus supports the “Monterrey Consensus”, and in particular is behind the Commonwealth action plan recently adopted in London, that aims at ensuring the effective delivery of the Monterrey Consensus. Indeed, the net transfer of resources from the developing countries to the rest of the world in recent years represents a disturbing development and it is hoped that the expeditious implementation of the Monterrey Consensus will reverse this flow.

In Cyprus, the last two years have witnessed the implementation of major economic policy reforms that have been directed at harmonizing the economy with the European Union. At the beginning of 2001 the system of determination of interest rates was completely liberalized with the removal of the ceiling of 9 per cent per annum on interest rates. Simultaneously, restrictions on borrowing from abroad by domestic entities were lifted and a further phased liberalization of the external capital account was effected over the following 18 months.

In mid-2002 a watershed taxation reform was instituted including elimination of harmful tax practices (as committed to the OECD in 2000) and harmonizing our tax laws and practices with those of the EU, embracing transparency, exchange of information and tax competition, as well as increases in indirect tax rates toward minimum EU levels. These and other reforms directed at phasing out state aid and increasing competition in domestic industry and in the public utilities sectors, have greatly enhanced the ability of Cyprus to

compete successfully and withstand the market pressures of entry into the European Union.

One lesson drawn from our experiences, is that taking measures to reform the economy, despite an adverse external environment, provides a country with enhanced ability to compete in this harsher environment and to have the flexibility to shift resources into areas of greater demand. Moreover, we would underline that policies of trade liberalization as advocated in the IMF's latest World Economic Outlook publication will benefit both developed and developing countries. Developing countries which have integrated strongly into the world economy with the liberalization of their external trade and capital accounts are proving that they can export their way out of a downturn and raise sufficient funds to bridge their temporary financing needs.

Cyprus backs strongly the international fight against money-laundering and against the financing of terrorism. We support the efforts of the IMF and the World Bank in contributing to this fight through their surveillance activities and technical assistance. Indeed, Cyprus has benefited from the favorable assessment and constructive comments contained in the IMF's report on "Cyprus-Offshore Financial Sector" (April 2001) following a staff mission to Cyprus in the context of the work of the Financial Stability Forum.