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

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It is an honour for me to make a statement to these Annual Meetings of the Governors of the International Monetary Fund and the World Bank Group.

I will concentrate my address on how the global economic situation and the OECD initiative against "harmful tax competition" can and are affecting certain small states like Cyprus.

It is again pleasing to note that the growth of world output and trade continues to be rapid and that the bulk of countries are benefiting from the improvement in the global economic situation. Of course, we would like to see the population of the poorer countries achieving greater increases in their living standards and participating more in deriving benefits from the globalisation process. In this connection we welcome the renewed focus and efforts of the IMF and the World Bank Group to reduce poverty, and trust that the provision of debt relief to the HIPC countries can be accelerated and translated into the actual alleviation of poverty.

At present the combination of a further strengthening of the US dollar and the continued maintenance of oil prices at very high levels is posing difficulties for major oil importers (both small and larger states) which have currencies that have depreciated significantly against the US dollar. The gains to the export sector derived from a depreciating currency are being offset by terms of trade losses that are associated increasingly with sharp increases in US dollar-priced oil imports. Correcting the imbalances lying behind these relative price and exchange rate changes is likely to be a slow and disruptive process. Already, we see in Europe a reluctance on the part of governments and the population to allow market forces to bring about adjustment, with much resistance to the passing on of higher costs of energy imports into increased domestic prices.

From the perspective of small open economies like Cyprus there is the danger that at any time they are quite vulnerable to developments in global markets. Cyprus is certainly benefiting from faster world economic growth and trade, particularly from the upswing in European economies. The benefits from the lower exchange rate for Cyprus, particularly on tourism exports, are being offset by the impact on higher import prices on current account payments and on the domestic inflation rate. There are of course increased pressures to further subsidise domestic oil prices. But such subsidisation would just result in higher fiscal costs and blunt the reallocation of resources toward less-energy intensive sectors, such as those providing financial services.

This brings me to the subject of how small states highly dependent on the production of a few commodities and/or services can diversify their economies, especially into production which is less dependent on energy inputs and which can tap into the globalisation process. In this endeavour, a number of small countries throughout the world have promoted the provision of offshore financial services not only for economic diversification per se, but to take advantage of the opportunities afforded by the deregulation of global financial services and increased international trade and corporate activity.

In Cyprus, our economic strategy since the late 1970s was to diversify away from depending on a few agricultural and manufactured products toward the development of the export-oriented tourism and business services sectors. And Cyprus, along with a number of countries in Europe, Asia and the Caribbean have been quite successful in these efforts, becoming important tourist destinations and offshore business centres.

The Cyprus authorities consider that there must be effective regulation of the financial services sector and the exchange of information and co-operation at an international level to avoid money laundering and other forms of financial crimes as well as harmful tax competition. Toward this end the Cyprus Government has agreed to associate itself with the OECD´s work against harmful tax practices. Furthermore, although financial services are a small part of the offshore sector of Cyprus, the government has taken all the necessary steps to minimise the vulnerability of the sector to money laundering. And following a detailed assessment, the Financial Action Task Force concluded in June 2000 that Cyprus has a comprehensive anti-money laundering system and was co-operating in the international fight against money laundering.

Even though Cyprus has associated itself with OECD´s work against "harmful tax competition" it recognizes that the OECD initiative could have a considerable adverse economic impact on small states that rely on the provision of offshore financial services. With this in mind it is felt that small states must co-operate more closely with each other, and with the Commonwealth bodies and the World Bank, the IMF and the World Trade Organisation to assess the potential impact of the OECD initiative and for laying the ground for a multilateral discussion of the global issue of "harmful tax competition". Indeed, the OECD initiative and the controversy surrounding the process adopted highlight the need for an international forum representing all nations, including small states to address the issues of harmful tax competition.

Despite a number of unfavourable disturbances to the Cyprus economy this year, including higher fuel prices and an increased VAT, the rate of growth of real GDP is forecast to be around 5 per cent and the rate of unemployment is projected to fall and average 3 per cent in 2000. After peaking at 4 ½ per cent in June 2000,the rate of increase in consumer prices is expected to decline and average 4,3 per cent in 2000. The strong growth of economic activity as well as higher indirect tax rates are boosting government revenues and it is currently forecast that the fiscal deficit in 2000 will fall to

3 ½ per cent of GDP compared with 4,1 per cent in 1999. In the Government budget for 2001, which has recently been tabled at the House of Representatives, expenditure allocations have been further restrained so as to reduce the government deficit to 3,2 per cent of GDP. This policy is in line with our objective of lowering the fiscal deficit to below 3 per cent of GDP by 2002 in order to harmonise our fiscal policies with those of the European Union and satisfy the relevant Maastricht convergence criterion.

In concluding, I will emphasise that Cyprus continues to support and cooperate with the Fund and the Bank in their efforts to foster a stable economic and financial environment conducive to healthy growth and development. Also, I would take this opportunity to thank the management and staff of the Fund and the Bank for the constructive advice they have rendered to Cyprus.