

A Doctor from the IMF

Vincenzo Guzzo, IMF Resident Representative for Cyprus

June 12, 2016

- 1) Mr. Guzzo, you have been the IMF Resident Representative in Cyprus, for the last three years. How would you evaluate the whole experience?

It has been an incredibly rewarding experience, from both a professional and a personal standpoint. I must say that the hospitality and generosity of the Cypriot people have made me feel welcome from the first day I walked into the country. On my side, I always tried to be sensitive to the difficulties the country was going through. And I interpreted my role as that of an advisor, a partner of the country authorities, as opposed to a “guardian of the memorandum.” I believe that helped gain a lot of mutual trust over time.

- 2) Could you explain us, which exactly was the IMF role in Cyprus during this period?

The interaction between the IMF and the Republic of Cyprus over the past three years has spanned the whole spectrum of core functions of the Fund. The most visible dimension has been the financial assistance program. A core responsibility of the IMF is to provide loans to member countries experiencing economic and financial problems. This financial assistance enables countries to restore financial stability, put public finance on a sustainable trajectory and achieve conditions for a return to strong economic growth. In this capacity, the Fund has been engaged in Cyprus in the last three years. This is certainly not the only role that the Fund has played in Cyprus though. The IMF also helps its member countries design economic policies and manage their financial affairs more effectively by strengthening their human and institutional capacity through technical assistance and training. Although less visible to the Cypriot public than the work done in the context of the financial assistance program, this is equally important. Extensive technical assistance and training has been provided to Cyprus lately with very tangible results.

- 3) How would you evaluate Cyprus and its people?

I can say without hesitation that Cyprus’ financial assistance program has been a success. After going through an unprecedented downturn, the economy first has

started stabilizing and then has come back to growth. The number of jobs is rising again. Banks are now adequately capitalized and their liquidity conditions have stabilized. Full market access has been regained. This was not easy to imagine three years ago. And the people of Cyprus should be given full credit for all the results the country has achieved. It is only their determination in addressing economic and financial difficulties and for taking full ownership of far-reaching reforms that has allowed this progress. Of course, now it is a matter of continuing along the same path.

- 4) Three years ago, following an unprecedented decision, we experienced a bail in for Cypriot banks. How just was this decision for Cyprus and would you expect that we will see it happening again for other countries?

It was a difficult decision, but it is even more difficult to assess the counterfactual, in other words what could have happened, had those measures not been implemented. Had upfront steps to deal with the banking system not been taken, then taxpayers would have been asked to foot the bill. This would have entailed onerous measures to correct imbalances and sustain public finances, which may have weighed adversely on the economy and perhaps discouraged foreign capital. Unfortunately, there is no quick fix to the economic crisis the country went through. Only steady and resolute implementation of structural reforms along the path already started can ensure a sustained return to jobs and prosperity. As for the case of other countries, the EU Bank Recovery and Resolution Directive empowers regulators to intervene when a bank is undercapitalized, including through involvement of its creditors. So, each case will have to be assessed very carefully going forward.

- 5) What would you say are the main issues that we owe to tackle in order to re-establish our economy on solid foundation?

First and foremost, Cyprus has to address its NPL problem. Dealing with NPLs effectively not only would have an impact on the balance sheet and the capital of the banks, but it would also have broader implications for the economy. By lowering NPLs, banks could increasingly extend new credit to families and corporations, and do that on better terms, thus supporting investment and jobs. In turn, stronger growth would increase borrowers' ability to repay, thus reinforcing the case for further reduction in NPLs. Banks' improved lending capacity would affect especially SMEs that are more dependent on bank financing. This is very important for Cyprus, where SMEs play a critical role in the

economy. Secondly, Cyprus has to ensure sustainable public debt. This would allow adequate fiscal space for productive public investment spending, which in turn would support long-lasting growth. Controlling the growth of the public sector wage bill and increasing the efficiency of the public sector through promotions and mobility across the civil service would be a critical step in this direction. Finally, Cyprus has to move forward on its structural reform agenda. Continuing to privatize state-owned enterprises would allow better and less expensive services for the population and it would attract foreign direct investment, which again can bring jobs and increase liquidity in the economy. Favoring deeper capital markets and encouraging the development of an investment fund industry, within an appropriate regulatory framework, would also help channel capital towards productive investment and it would reduce over-reliance on bank credit.

6) Which will be IMF task in Cyprus after the end of the adjustment program?

As part of its international mandate, the IMF monitors economic developments in its 189 member countries, highlights possible risks to stability and advises on necessary policy adjustments. This will be even more important in a country like Cyprus, which just exited an adjustment program. And, of course, if requested, the IMF will continue to provide technical advice in a broad range of areas.

7) Many countries accuse IMF of its proposed solutions and adjustment programs. What is your comment on this?

The IMF is like a doctor. There is always a tendency to blame the doctor if the treatment is not pleasant. What I can say though is that waiting too long to see your doctor and then getting admitted to the emergency room is never a good idea.

8) How immigration will modify Europe's economies?

If we are referring to the dislocation of the population of Syria and other conflict zones, let me say that this is first and foremost a humanitarian catastrophe. As for the economic impact of this crisis, in the short-term, the effect from the refugee will likely be a modest increase in GDP growth, reflecting the fiscal expansion associated with the support to the asylum seekers, as well as the expansion in labor supply as the newcomers begin to enter the labor force. In the long-term, the impact will depend on how integrated they will be in the labor

market. Successful labor market integration may help counter some of the adverse effects of an aging European population.

9) What consequences do you expect on international economy because of the terrorist actions?

The impact of terrorism can be widespread, ranging from national income losses to growth-retarding effects, from dampened foreign direct investment to effects on international trade. Increased terrorism in a particular area tends to depress the expected return on capital invested there and shift investment elsewhere. This reduces the stock of productive capital and the flow of productivity-enhancing technology to the affected nation. Studies show that most countries that experienced above-average terrorist incidents received less foreign direct investment.

10) Does IMF have a strategy in order to help countries overcome the terrorism consequences on their economy?

Structural reforms and sector diversification help an economy withstand external shocks, thus including the effects of terrorist attacks. In a well diversified economy, if terrorism disrupts productive activities in one sector, resources can more easily flow to another unaffected sector. In contrast, economies which are more vulnerable to external shocks or are overly-specialized in one or just a few sectors may not have such resilience.

11) You worked on several assignments worldwide, including Iceland, Yemen and Italy. Is there a country where you would definitely say that the economic situation was terrible and how would you compare Cyprus with them?

This is a difficult question. Each country has its own story and it is difficult to make comparisons. What I can say is that only three years ago the two largest domestic banks in Cyprus, which together accounted for four times the size of the country, were found to be economically insolvent. Three years on, the banking system is adequately capitalized, liquidity conditions have stabilized, and the economy has moved back to growth. Of course, there is still plenty of challenges to deal going forward, but I rarely recall such a comeback in any of the other countries I was involved.

12) What would you describe as the “strongest cards” for Cyprus economy and towards which direction would you advice the officials to build its future?

A highly-educated labor force, technical skills in the legal, accounting, auditing and consulting fields, widespread knowledge of the English language, and a strategic geographic position at the crossroads of Europe, Middle-East and North Africa are all strong cards to attract foreign direct investment. However, Cyprus has to work harder in developing a business-friendlier environment. In this country, it takes an average 617 days to deal with the construction permits to build a warehouse and an average 1,100 days to enforce a contract. Targeted reforms in specific areas can go a long way. They can allow Cyprus to fully leverage on its strong cards and seize the opportunities it faces on the road to long-lasting growth.