

The Composition of Government Revenues in Cyprus, 2002-2008

Polyvios S. Eliofotou

European Commission

Abstract

Between 2002 and 2008 the Cypriot economy has been growing at an annual average rate of about 3½% in real terms, significantly above euro area. In parallel, total tax receipts grew on average at 11% per year, leading to an average annual elasticity with respect to GDP of about 1½. This increase in tax revenues has contributed significantly to the improvement of the Cypriot budget balance. The purpose of this paper is to assess the extent to which the tax-revenue increase is of a permanent nature or is to a large extent associated with temporary changes in GDP composition. The conclusion is that in Cyprus, a large part of the increases in tax revenues is structural, being the result of tax harmonisation measures adopted in the run-up to EU accession. However, the developments which led to the remarkable revenue performance in 2007 might be of a temporary nature, driven by a short lived asset boom. This, at the current juncture when a significant slowdown of the Cyprus economy is in sight and tax revenues could shrink, calls for maintaining fiscal prudence, especially in the light of the high external imbalance.

Keywords: Cyprus' tax elasticities, composition of government revenues, tax burden, asset repricing and tax revenues.