Newsletter issue 7 – February 2006

The seventh issue of 'Economics Research' contains articles on the effect of foreign workers' labour on GDP, the impact of government investment on the productivity of the Cypriot economy and the relationship between the stock market, financial uncertainty and economic growth.

The percentage of legal foreign workers in Cyprus has almost reached 14.6% of the working population. In the last eight years (1997-2004) the average annual growth of legal foreign workers was at 13.9%. Today it is estimated that legal and illegal foreign workers account for about 20% of the working population. According to our estimations the contribution of foreign workers to the growth rate of total gross value added in 2004 compared to 1995 was 54.2%, which is the highest contribution among all factors of production. If the number of foreign workers in 2004 was the same as that in 1995, the increase of total gross value added would have been 16.9% instead of 36.9%, while at the same time the average annual growth rate would have been 1.6% instead of 3.4%.

Econometric analysis of the effect of government investment on the productivity of various sectors of the economy, shows that government investment increases the growth rate of productivity in sectors with very high fixed cost (utilities, communications etc), as well as in sectors that are not technology intensive (agriculture, fishing etc). Furthermore, government investment accelerates productivity growth in sectors that contribute to infrastructure (construction, transportation, communications). In the remaining sectors (especially services) government investment is not as beneficial, with regard to productivity growth, as private investment.

For the analysis of the relationship between the stock market, financial uncertainty and economic growth, data from the US, Canada, Japan, UK, Germany, Cyprus, Argentina, Brazil, India, Korea and Malaysia were used. The general conclusion is that financial stability is important for economic stability because, according to the results, there is causality from the variation in the stock market to the variation of economic growth of the economy. Moreover, a financial crisis does not affect the form of the relationship between financial and economic stability but does affect the intensity of this relationship. Especially for Cyprus, results indicate that the financial crisis of the period 2000-2002 resulted in reduced ability of the stock market to forecast the evolution of the future economic activity, and that an unexpected financial crisis will affect the future real economic variables such as the output growth rate.