

Newsletter Issue 32, March 2016:

The topics addressed in this issue of Economic Research are the following: (i) 'The CypERC property price index: Data and estimation method', by Karagiannakis Ch., P. Pashardes, N. Pashourtidou and S. Andreou, (ii) 'How Can Cyprus Meet Its Energy and Climate Policy Commitments? The Importance of a Carbon Tax', by T. Zachariadis, (iii) 'Comparisons of Productivity among European Sectors and Cyprus: The Case of Tourism Sector', by Ketteni E. and T. Mamuneas, (iv) 'The Cyprus Adjustment Programme - Necessity or Wrong Medicine', by Charalambous A., (v) 'What Policy Innovation for Youth in the Era of Prolonged Austerity? The Case of Greece', by Petmesidou M. and P. Polyzoidis, (vi) 'House Price Dynamics and the Reaction to Macroeconomic Changes: The Case of Cyprus', by Savva C. Below, we list the short summaries of the aforementioned articles:

(i) The current economic crisis in Cyprus revealed the need for the development of tools for monitoring changes in the domestic property market. In particular, this paper: presents details on the construction of a new database, using newspaper advertisements of monthly prices and related information about various types of property (houses, flats, plots etc.) in different districts of Cyprus over the post-2000 period, propose scientifically appropriate models for the estimation of property price indices that can provide a measure of the quarterly change in property prices, together with an assessment of the reliability of this measure, propose econometric models for the analysis of the factors (property characteristics and macroeconomic variables) which affect property prices and propose econometric models for the systematic estimation of projections for the future evolution of property prices.

(ii) The paper presents a new set of energy demand forecasts for the Republic of Cyprus up to the year 2040, taking into account recent oil price developments and focusing on the ability of Cyprus to achieve the greenhouse gas emission reduction targets agreed by EU leaders in October 2014. The emphasis is on emission reductions in those sectors that are not subject to the EU Emissions Trading System, i.e. on final energy demand sectors excluding aviation and the cement industry. According to a 'baseline' scenario, energy demand will grow modestly over the coming decades, which is far from sufficient for Cyprus to achieve its 2030 emission targets. We therefore develop two additional scenarios that assume the implementation of an economy-wide carbon tax from 2016 onwards. It turns out that a strong tax increasing by around 15 Euros per tonne of CO₂ every year from 2016 onwards is necessary in order to induce a sufficient decline in carbon emissions, or alternatively a carbon tax that can start from very low levels and increase geometrically up to 2030. Such taxes, which are also recommended by international organisations, would lead to a more rigorous implementation of energy efficiency measures in buildings and transport than currently foreseen, and would allow Cyprus both to comply with the EU decarbonisation targets and to reduce its dependence on fossil fuels.

(iii) The importance of the tourism industry for economic, social and cultural development in Europe and the role of tourism as a driver of development are well known. In Cyprus tourism industry is one of the five biggest industries with a 7% share in the GDP of the economy. The tourism sector was and will be very important in the future as far as the economic growth of the Cypriot economy is concerned. For the tourism sector to continue to grow it needs to improve its competitiveness, especially since lately we are facing large competition not only from the south Mediterranean countries but from new star performers in Central and Eastern Europe. One way to improve competitiveness is via increasing its productivity. In this paper we examine how factors such as the quality of service, quality of the environment, public infrastructure, culture and safety can explain the observed output

and productivity differences among Cyprus and 21 European countries. In addition to these factors, the output difference of tourism industry is decomposed to capital and labor input differences and productivity differences. For our analysis we have collected recent data from Eurostat, covering a period before and after the economic crisis (2000-2012) on the tourism sectors of 21 European countries. Our sample consists of the following countries: Austria, Belgium, Bulgaria, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Italy, Lithuania, Luxembourg, Netherlands, Poland, Portugal, Slovakia, Slovenia, Spain and UK. We find that the countries with the highest output difference are: Spain, Italy, UK, France and Germany, followed by, Greece, Austria, Netherlands, Portugal and Belgium. The rest of the countries are below the hypothetical country with respect to output of the tourism industry. Those with the lowest output are Estonia, Denmark, Lithuania and Czech Republic. We observe that in most of the countries the major contributor to output differences is traditional inputs. This result indicates that countries with a large labor force (size) and high investment will have larger positive output differences, while countries with a smaller labor force and less investment will tend to be below the average with respect to output. After controlling for the size of the labor force and investment in a country we observe that quality of services and the government expenditures on safety, culture and infrastructure have a positive contribution to the output difference of the sector. As expected, quality of the environment captured by waste generated has a negative contribution to output. Finally, with respect to productivity differences we see that its contribution varies and it's a significant one. Cyprus is below the hypothetical country with respect to output, and close with respect to observed productivity. As in the other countries, the major role comes from traditional inputs. It seems though that government expenditures on safety, culture and infrastructure and quality of services are not sufficient to enhance Cyprus to a better position.

(iv) This paper attempts to evaluate whether the Cyprus adjustment program signed with the Troika was a necessary precondition to correct the imbalances in the economy in 2013. Although the factors leading to these imbalances appeared to be of exogenous nature, it is argued that the underlying problems were homegrown. In 2008, the Cyprus economy presented a satisfactory picture. However a careful assessment would have brought to the surface the hidden structural imbalances, which led in the subsequent years, to an unsustainable bubble. These home grown imbalances were not addressed, in contrast adjustment was delayed and the negotiations with Troika took an unduly long time to conclude, with severe consequences. Against this background, the implementation of the adjustment programme of Cyprus is considered as successful. However, given the rather low growth prospects further reforms are required. In the current debate, there is some support for utilizing the perceived fiscal room to stimulate the economy. However, it is argued that the case for adopting an expansionary fiscal stance is not strong given the still high level of public debt. Some elements of MOU are highly controversial. The most prominent one was the bail-in of uninsured depositors. This paper argues that, instead of imposing upfront losses to the uninsured depositors, a long-term adjustment path in the banking sector would have been preferable, because it would have allowed the economy to adjust in a smoother manner without damaging the confidence in the banking sector. At the end of the paper the issue of political ownership of the reform program is raised.

(v) Greece is experiencing a prolonged crisis that has brought record unemployment across the entire labour force. Youth unemployment is a structural problem predating the crisis, but has been deeply aggravated by it. The first part of this paper examines various facets of youth joblessness in Greece, in comparison to other European countries. It disaggregates unemployment incidence by gender and level of qualification and traces the labour market and poverty risks for youth, against the backdrop of increasing employment flexibility and

insecurity. The second part provides a concise overview of the institutional context and policies in respect to transitions from education to the labour market. The focus is on barriers to a (more or less) systematic process of evidence-informed policy making. In the light of this discussion, and in the context of the bailout-instigated reforms, the third part briefly reviews policies for tackling youth unemployment. The Youth Guarantee programme is singled out as an intervention that can potentially trigger innovation in policy management, though it is far from resolving the youth employment crisis.

(vi) This paper applies a two-regime Markov switching model to investigate the impact of the macro-economy on the dynamics of the housing market in Cyprus for the period from 2001 to 2014. The econometric methodology implemented in this study suggests that the behaviour of housing market in Cyprus is regime dependent and allows for a clearer understanding of the drivers of the housing market during “boom” and “crash” periods.