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## THE CYPRIOT MODEL AND THE TRAP OF THE THREE CRISES

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*Speed is irrelevant if you are going in the  
wrong direction  
Mahatma Gandhi*

It has been almost a decade since the banking crisis of 2013. The word “crisis” still very much remains part of the general public narrative. Following the two years of the global lockdowns, which were a serious blow to the local service economy heavily dependent on the international demand, now Cyprus suffers losses across its key industries as a result of the Western sanctions against Russia.

While businesses try to minimize the damage and search for diversification of the client base, it is the moment of reckoning both for the expert community and the state administration at all levels. It is now the time of “back to the drawing board”, it is now the time, finally, to reflect on the Cypriot economic model in the context of the new global reality – the model, which served the country well from the early 1980s till the financial crisis of 2008. Any assumption that after a year or two things will go back to “business as usual” is dangerously false because, fundamentally, they never really did after the banking collapse of 2013. Retrospectively speaking, there was an illusion of “normality” created by the relative stability of the tourist arrivals and ship registrations, slowly-moving reforms (including declarations of intentions to reform) as well as the inertia of the old-paradigm thinking driven by the unconscious collective hope that things could really return to where they were during the Cypriot version of France’s “the thirty glorious years”, the post WW2 period of stability, peace and ever-growing prosperity.

Another important factor, which helped to sustain the illusion of “return to normality” was the relative economic stability of the European and international economy between the Great Recession of 2008 and the Pandemic of 2019-21. But few people outside the expert community reflect on *how* it was actually achieved. This relative stability balancing on the verge of stagnation was the result of a decade-long very skilful *artificial stimulation* by major global central banks led by

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the Federal Reserve System of the United States. The series of multi-year coordinated Quantitative Easing (QE) programs, i. e. complex financial operations on injection of liquidity, saved the world from falling into the global depression, and produced an anaesthetic illusion of solidity of the system, which faced no fundamental challenges to be prepared for. Another aspect was that the financial crisis and the consequent stabilization did not really shake and touch on the social/humanitarian and political/military dimensions of the old global architecture, and therefore, did not produce a true deep comprehension (especially among political decision makers) that the 2008 crisis was the Rubicon of our generation, the end of the old system and the beginning of a historical paradigm shift. Even the Russian annexation of Crimea in 2014 and the Migrant crisis of 2015 were not strong enough political/military and social/humanitarian events for the Western, and especially, the European leaders to understand what the systemic change means and how it works. *A fundamental change in one of the critical elements of the whole will automatically lead to a similar change in all other elements of the system, even if there is a time lag in between the events.*

Therefore, they chose the “ostrich policy”, preferring to generally ignore the obvious matters (especially in case of annexation of Crimea) and pretending that nothing fundamental happened, which would otherwise require leaving the comfort zone and reshaping the whole system. The result of such a strategy was the massive blowback in the form of a social/humanitarian crisis in 2019-21 and a political/military crisis in 2022. The biggest mistake was not even the lack of coordinated strong response with regards to the two events in 2014 and 2015, but the collective short-sightedness and reluctance to make any drastic *internal* changes in order to increase the overall joint preparedness and cohesiveness as well as the resilience capacity against such crises in the future at the European and national levels. The main brunt of responsibility is born by political and big business leaders, who preferred to return to “business as usual” as quickly as possible. At the same time, the general public always bears its own share of responsibility for the stubborn objection to necessary reforms even when they are proposed and promoted.

Now the circle of paradigm-shifting crises is complete: the Great Recession of 2008, the Pandemic of 2019-2021 and the Ukrainian War of 2022. Each of these historical events represents a point of no return to the world of yesterday and to the “business as usual” as we knew it in the era, which has gone. Each of these crises became a trigger to the dismantling of the old architecture in the most critical spheres of the system: financial/economic; social/humanitarian and political/military domains. Together they inaugurate the period of unpredictable mutually-reinforcing dynamics of decompression, fragmentation, polarization and contestation not only between the global centres of power like China, Russia, Europe and the US, but also between the communities, social and political groups, regions within countries, and countries within the blocks such as the European Union.

The three crises put an end to the era of the expansionist dynamics of financial globalization, elimination of barriers, institutionalization and harmonization of common rules and regulations as well as the post WW2 order based on the

principals of territorial integrity and sovereignty of the nations-states, and the prevalence of the international law.

It is in the context of these three crises and their consequences that the Cypriot model should be analysed and reformed. Any argument that there is still a chance to return to the old normality should be dismissed. As famous French diplomat Talleyrand once said: *"THIS IS WORSE THAN A CRIME. IT'S A MISTAKE"*.

### **The genesis of the Model**

Cyprus has built an open service economy based, primarily, on the three dominant pillars: tourism for the international middle and lower middle class, ship registration/management, and financial/corporate services as well as, at a smaller scale, the internationally-oriented tertiary education sector.

This economic success was achieved on the back of several fundamental historical processes:

- De-colonization of the 1960s-70s, which left the country with the legal system based on the English law, business-oriented taxation and the financial system built on the Anglo-Saxon model as well as the availability of the English-speaking population, lawyers, accountants and bankers, i.e. a combination of critical factors necessary to run an international financial centre in the world of the emerging globalization. The Cypriot financial system began reaping its first benefits after the Islamic revolution in Iran, when it became a natural financial transit point for capitals fleeing the country and heading West. Since then, the geographic proximity and the availability of accommodating financial centre, was bringing profits every time a destabilization was happening across the wider Middle East, the Balkans and the former communist block;
- The financial globalisation launched in the US in the 1980s became a single most important factor, which allowed all the key Cypriot industries to live through the unprecedented period of the decades-long uninterrupted growth. The essence of the mechanism was the stimulation of growth through the financial de-regulation, economic liberalization and stimulation of consumption of the middle class, primarily, through the debt accumulation (i.e. debt refinancing). Simultaneously, the rich countries aggressively shifted to the service economy (retaining, though, the high value-added manufacturing segments) and moved their "old economy" low value-added production to the cheap-labor countries overseas. This mechanism (debt-fueled consumerism in the West and the relocated industrial production, mainly, in East Asia) required further liberalization and lifting of barriers at the international level in order to facilitate the free movement of people, goods/services and capital, which in turn, led to the explosion of the international trade, transportation/logistics, tourism, entertainment, retail, international education and the financial services sectors. This is when the low-tax jurisdictions like Cyprus with the loose regulation and the internationally-oriented service sectors won their "lottery ticket";
- Collapse of the USSR and of the communist block (which, by chance, coincided with the rising wave of globalization) made Cyprus one of the major beneficiaries of the process. The historical cultural ties, geographic proximity

and the Anglo-Saxon low tax financial system made the island a natural choice as an entry point into the international economy for a big part of the wealth accumulated behind the Iron Curtain. The secrecy laws and lax regulation in Cyprus suited well businessmen from the post-communist countries, where rampant corruption and lack of solid legal, law-enforcement and institutional frameworks were strong enough a motivation to siphon their money abroad. The size of a hefty transaction fee Cyprus was earning from Russia/CIS states increased many-fold when the global oil and commodity boom began in the early 2000s. The cycle of high oil and commodity prices, which lasted almost fifteen years, secured a massive long-term inflow of capital and demand not only for the Cypriot financial services industry but also for tourism, ship management, real estate and tertiary education sectors. According to some conservative estimations of Russian economists, at least 1 trillion USD was siphoned out of the country over the thirty years since collapse of the USSR. A considerable amount of that money was channelled via Cyprus, bringing it a solid long-term profit. On the flip side, however, a disproportionate dependence of the local economy on the Russian/CIS demand was created.

- The accession to the EU in 2004 could be compared to a grand prize, and a manifestation of a long-term success. Thirty years after the Turkish invasion, a once impoverished country, managed to qualify for membership in the richest economic club on the planet, which at the time reached the peak of its harmony, wealth and prosperity. Cyprus joined the Union having one of the highest incomes per capita among the new entrants, which was the direct result of the three above factors. Membership in the EU, and later in the euro zone, immediately elevated the status and attractiveness of the Cyprus jurisdiction as an entry point into the European common market, which became the source of significant additional investment inflow from the non-Western countries. Over the years, the local economy was also the net beneficiary of the EU's structural, development and rescue funds.

There is, however, one more critical element, which allowed Cyprus to reap the benefits of all the above historical processes. It is always mistakenly omitted from any economic analysis, since it is never considered as a separate stand-alone factor. And this is the cold peace on the divide line.

Since the invasion of 1974 only eight people were killed on the line – the number that is smaller than a statistical error in the natural demographic loss, and which makes the Cyprob the most peaceful conflict on the planet. The stability on the divide line was a single most important non-economic factor, which substantially contributed to the uninterrupted rise of the Cypriot economy. The important contribution to the stability was, among others, the absence of the *direct economic competition with Turkey*. Fortunately, the two economies had different size and structure, and were reaping the benefits of the globalisation by running on different tracks, without ever facing each other in the head-on competition for strategic economic assets. This played a very important role in building the island's reputation as a safe and peaceful destination for holiday makers and the international business.

In general terms, Cyprus rose on the back of the era of *relative international peace and stability*, when the number of regional conflicts and civil wars dropped significantly, and most of the countries mainly tried to adhere to the international economic and political norms formulated in the wake of the Cold War. It was the period, which could be called the era of the international economic and political “convergence”, a comfortable time of *relative certainty and predictability* with the understandable common rules of the game.

*The three decades of an uninterrupted rise and an ever growing prosperity created a false sense of invincibility and uniqueness of the local economic model, which flourished even during the periods of cyclical recessions in the West, being driven by the engine of lucky co-incidence of the powerful and lucrative for Cyprus historical processes described above.*

However, there were some *structural deficiencies* forming inside the model over the years of success, which nobody could or wanted to notice, let alone change. In general terms, they do not represent any risk as long as the global system continues growing, and remains an open liberal space with the harmonized rules and regulations. The specific characteristic of the local economy, which makes it vulnerable, is its *client base and one-directional flow of capital*. Cyprus rose, mainly, on the money from the emerging market countries of Eastern Europe, Russia/CIS and the Middle East, and remains to this day heavily reliant on it. Unfortunately, these are all peripheral in relation to the core (West Europe – North America – Japan) economies, predominantly commodity-producing and export-oriented countries, which heavily depend on the demand from the West and China. The corporate/financial sector in Cyprus earned its transaction fee, mainly, by channeling the money from the periphery to the core, which was its final destination, or from the periphery back to the periphery, playing the role of the transitional tax-optimization point. As for the reverse mechanism, there was practically no capital flowing from the West to the periphery via Cyprus. The rich countries used their own financial hubs for such transactions. It remained a low-tax jurisdiction, which was providing, mainly, one-directional corporate/financial services to clients from the peripheral economies – clients, who in general terms, earned their money from the *sales of low-tech low value-added products to the West, and then wanted to deposit, spend and invest these profits, again, in the West.*

*This is the simple mechanism Cyprus flourished upon for several decades. There was nothing wrong with it as long as the capital flow continued uninterrupted and on a large scale. However, the moment the money in the developing world dried down due to the falling commodity prices, declining demand in the West, shrinking international trade or geopolitically-motivated restrictions, the Cypriot economy immediately found itself in trouble. And it became evident that in spite of being formally part of the collective West, Cyprus had a low economic integration and co-dependence with the rich world but rather with the vulnerable economically-peripheral states. The complex global crisis, which erupted back in 2008 and was aggravated by the local banking crisis of 2013, demonstrated that by playing the role of the intermediary between the rich and the developing countries, Cyprus was rather the financial agent of the latter and not of the former, because it was*

servicing the money of the periphery and not that of the core of the world economy. This argument is strengthened by the profile of the local tourist industry, which continues catering its services and remains largely dependent on the same emerging market countries. The strong popularity among the British is explained rather by the historical ties. Similarly, the ship registration sector flourished on the back of the constantly-growing international trade, which was driven by the Western demand for the goods manufactured in the export-oriented emerging market countries. It is important to bear in mind the profile of an average container ship: it is usually a vessel loaded by two-thirds with low-tech low value-added manufactured goods travelling from a developing country to the rich consumers in the West. And once the demand falls or the supply chain gets disrupted due to humanitarian or geopolitical crises as it does today because of the complex global paradigm shift, the intermediary transaction center loses its revenue.

For the sake of fairness, it must be admitted that following the 2013 crisis efforts were made to diversify the client base of the tourist industry and attract the West European consumers. Similarly, the financial services sector introduced (under the pressure from the EU and the US) important regulatory reforms, which allowed, for example, the investment fund segment start developing on the island.

Nevertheless, the fundamental vulnerabilities of the Cypriot economic model in the face of the growing multidimensional risks of the new era remain:

- low level of economic integration and co-dependence with the richest and technologically-advanced core economies of the West Europe and North America;
- high dependence of the key sectors on a small number of mainly resource-producing peripheral developing economies in terms of sources of income and the origin of the investment capital;
- low level of knowledge/technological intensity in the main income-generating industries;
- growing vulnerability to the intensifying political, economic, regulatory and logistical disruptions, disputes and conflicts between the global economic core and the periphery as well as among the peripheral centers;
- sharply growing exposure to the regional security and humanitarian crises;

As it was mentioned earlier, there would be nothing wrong with the model, had the era of the expansionist economic growth, liberalization, new markets, falling barriers, peace and relative respect for the established international norms continued uninterrupted. *The era, which lasted roughly forty years, is over now.*

### **The trap of the three crises**

It is clear today that the cycle of relative peace, stability and economic harmonization is giving place to the uncertain period of strategic instability, polarization and worsening economic and technological competition. The intensifying international confrontation becomes increasingly hostile, which makes the world more fragmented and uncompromising. We are actually living through

the process of dismantling of the old international system of laws, regulations, norms and practices, and logically, the simultaneous weakening of the international organizations and agreements, which enacted those rules, supervised their implementation and executed the arbitration. This trend represents a serious risk to become the international institutional crisis with all the relevant consequences.

*This requires the Cypriot leadership (current and future) to take a long strategic view on how to steer the country in the increasingly turbulent world, which in itself represents a monumental task of reconciling a delicate balancing with the bold action and tough choices.*

Whatever strategy is chosen, it will be unable to ignore and avoid the reality of the long-term mutually-reinforcing dynamics triggered by each of the three crises, which will remain the defining factors in shaping, at least, the transitional period to the new world economic and security architecture.

A detailed analysis of each of the crises is outside the scope of this paper, however, the main takeaways to bear in mind are the following:

- The Great Recession: secular (long-term) stagnation; centrality of central banks as the principal institutions guaranteeing stability at the national and international levels; the end of the post WW2 middle class; intensification of social polarization and widening income gap.
- The Pandemic: nationalism of exclusion; failure of solidarity and emergency cooperation; unintentional but successful operational testing of the mechanism of organized disintegration, suspension of laws, agreements and regulations at the national and international levels; re-emergence of a nation-state.
- The Ukrainian War: the end of the post-WW2 security architecture based on respect for state sovereignty, territorial integrity and the prevalence of the international law; long-term isolation of Russia by the global economic and technological core, representing more than 65% of the world economy; deepening of the European fragmentation.

The most critical negative factor of all is the *secular stagnation of the global economy*. This is a complex phenomenon directly linked to the historical evolution of the world economy as a system, and unfortunately, there is no quick fix in sight. The very fact that it took the Federal Reserve and the ECB alone seven (Fed -4; ECB - 3) multi-year QE programs to artificially stimulate and keep the economy afloat over the period between 2008 and 2020 (excluding the massive support programs during the Pandemic) speaks for itself. Similar programs were under way in other major economies. The problem of stagnation will stay there with us for years to come, and will require a very different set of social-economic management tools.

*For a peripheral economy like Cyprus It is therefore vital to remember how the mechanism of stagnation works: the farther the country (financially and technologically but not necessarily geographically) from the core of the global economy, the less it is integrated with the center, thus, the more primitive its*

*economic structure is and the more peripheral the economy is. Consequently, the faster and the deeper it will feel the destructive effect of stagnation at economic, political, social and personal level.*

Therefore, it is very important to realize that the country's most valuable assets are not the illusionary energy reserves or the beautiful beaches but actually the membership in the EU, in the euro-zone and the belonging to the collective West. At least, as far as the short to medium-term economic problems are concerned, the access to the common EU funds will help to mitigate the inevitable losses and stay afloat. Membership in the euro zone makes the country more attractive for foreign investors, and defines the status of the economy as part of *the first world*. On the political and security front, it is the very belonging to the collective West, which provides the shield to the Republic of Cyprus, automatically serving as a restraining factor in this increasingly dangerous region. It is a well-known fact that in the eyes of many Cypriots the EU and the collective West do too little for the Cypriot cause. However, nobody should forget that without the membership in the *first world*, the plight of this country would have been much worse, especially, in the current ongoing environment of the geopolitical decompression of the world and of the region as well as the intensifying global economic stagnation.

It is equally important to realize, though, that there is fierce intensifying competition within the first world as well for the diminishing returns in the world of stagnation, and nothing guarantees a free ride in the first class forever. That is not to say there is the immediate risk of exclusion, which will necessarily see further development, nevertheless, the initial symptoms of such potential scenarios have already manifested themselves. *And a peripheral, geographically distant and vulnerable country, like Cyprus must take a note.*

The truth is that the European Union is the product of the post-WW2 peace, stability and growing prosperity, and its post-communist period of economic and political expansion was driven by the same historical forces, which benefited Cyprus. That was the period of plenty, when there were enough resources to admit and accommodate many relatively poor new members on the basis of ideals of solidarity and shared European destiny. Whether the EU will stay true to its fundamental values during the hardest test of times in the future remains to be seen.

*The Pandemic and the ongoing Ukrainian war produced some disturbing signals.* The experience of the first lockdown in Spring 2020, which was supposed to be the moment of solidarity and coordinated action, has become instead the manifestation of the "*nationalism of exclusion*" and of the indifference the Europeans were showing to their neighbours and to fellow member states on the other side of the continent. The Europeans demonstrated to each other that behind the visible tolerance, smiles and political correctness, there is still enough of chauvinism, nationalism, distrust and disrespect harboured both for each other and for the common EU laws and regulations. The unilateral suspension of the Schengen agreement (which was the biggest symbol of the historical unification of Europe) by some individual countries has become the epitome of disunity, and



has actually given a glimpse of a possible future scenario at the moment of the urgent need.

The Pandemic was obviously the most difficult period in recent history, but it was also a period of the immeasurably valuable experience. On the one hand, it demonstrated the vulnerability of the outsiders and of the periphery in general, but on the other, the wealth, the power and the resilience of the North-Western European core. It demonstrated that the richest countries in the North-West of Europe can relatively easily adapt and survive without the rest of the periphery in Central and South-Eastern Europe. They still possess enough wealth, technological and industrial capacity as well as the administrative/managerial expertise to restructure the system and live in the new conditions without suffering losses, which would put them on the brink of the existential threat. The pandemic period provided, although an unintentional, but a very practical blueprint of the action plan in case of any future emergency exit of the North-West from the EU. This is obviously an extreme scenario, and there are many other complex political, cultural, historical and security considerations, which represent the "raison d'être" for the Union. However, the peripheral states must make an honest evaluation of their weaknesses, vulnerabilities and threats they might face in the relatively not so distant future, *including the possible restructuring of the bloc under the pressure of the economic stagnation, when "the shared destiny" might become too burdensome to finance for a much richer "old Europe"*.

It is not useless to shake off a dust of the long-forgotten "White Paper on the Future of Europe: reflections and scenarios for the EU27 by 2025", released by the EU Commission in the wake of the Brexit crisis in March 2017. At the time it was viewed as a desperate attempt by the pro-euro camp to build a bridge and offer a compromise to the euro-sceptics in order to "save" the future of the Union. The Paper re-introduced the idea of the "*multi-speed Europe*", which opened the possibility of the European integration at different speeds, thereby giving the euro-sceptic countries the room for manoeuvring without destroying the Union. However, the recent pandemic experience and the reality of the stagnation allows to look at the proposal under the completely different angle. What was initially viewed as a failure for the pro-Europe camp in the West and a victory of the euro-sceptics in the East, who successfully defended their "sovereignty" from Brussels and Berlin, can now be turned around and be easily interpreted as a useful and practical plan for the core West European bloc to gradually get rid of the heavy financial burden in the South and in the East by introducing the "soft" barriers in front of the poorer members through the mechanism called the "multi-speed Europe". The pandemic provided the core West European countries with the unexpected experience, which served as a test polygon for the emergency scenario they used to fear the most, i.e. *the abrupt and chaotic disintegration of the bloc*. That does not mean that the scenario planning will eventually turn into the action plan in the near future. Even in the West, there is no clear realization yet that they might face the inevitability of such a development within the coming years. Nevertheless, the scenario of the multi-speed Europe, initiated by the Western core with the aim of reducing its burden and gradually introducing the "economy class" in the South and the East of the bloc, can no longer be viewed as "exotic", and its probability will depend on the depth of the economic and financial problems

in the coming years as well as the ability of the West and the East of the Union to find compromises on multiple issues, including the common defence policy, which will increasingly become a thorny issue, especially, in the wake of the Russian invasion of Ukraine.

The war, unfortunately, is far from over, however, it has already set in motion the dynamics, which will probably lead to the fundamental changes similar to those caused by the dissolution of the USSR and the collapse of the communist block (the scenario of a nuclear war is not taken into consideration in this analysis). The outcome of the long battle is unknown yet, but some conclusions can already be drawn:

- the isolation of Russia by the collective West is for the long-run. As Elvira Nabiulina, the head of the Russian central bank (who is widely recognized as one of the most competent technocrats in the country) recently said: "sanctions, probably, are there forever to stay". As far as the Cypriot economy is concerned, the recipe is tough to swallow but simple: "accept, get over it and move on".
- the similarities between the *Russian invasion of Ukraine* and the *Turkish invasion of Cyprus* are direct and clear: military intervention and occupation of a territory of a sovereign state under the pretext of protection of the ethnic minority from the presumed atrocities of the "illegitimate" government as well as the proactive prevention of hostile intentions by regional players to change the balance of power, threatening the national security of the invader; the main propagandistic justification: "we never wanted the war, but we were provoked and were left with no other choice"; the establishment of a pseudo-state (or states) on the occupied territory and its (their) consequent unilateral recognition; deployment of the occupant military forces for an indefinite period of time; diplomatic efforts on the recognition of the pseudo-state(s) by individual foreign countries or groups of countries.
- Victory or defeat of Ukraine in the war will have the direct effect on developments around the Cyprob. The outcome of the war will shift the general international atmosphere with regards to the issues of invasions of sovereign states, territorial integrity and the respect for the international law. The defeat of Ukraine on the battlefield, and the consequent silent recognition of the loss by the West, will shift the balance in favor of the two-state solution in Cyprus, and will increase the risk of a military conflict around the island. In the atmosphere of the Ukrainian defeat, any appeals by the Republic of Cyprus for the respect of the international law and territorial integrity will be futile. The ROC might find itself under the mounting pressure of the collective West to give up on its occupied territories for the sake of stability and peace in the region. This would require the accommodation of the emboldened Turkey and its demands, which will be very similar to those of Russia in relation of Ukraine today. This would be exactly the type of pressure and tactics some major West-European powers tried to put on Kiev over most part of the conflict before they met fierce opposition both from the Ukraine and its allies in Central Europe and Britain, which were supported by the United States. It is vital to understand that for decades the key

element, which helped the ROC to successfully appeal to the international community, and block Turkey's international efforts on the diplomatic recognition of the "TRNC" by other countries, was the post-WW2 principal based on the respect for the state sovereignty, territorial integrity and the international law. For decades the reference to the UN resolutions on Cyprus was the convincing foundation of any Cypriot diplomatic campaign and argumentation in front of the foreign governments, which from time to time were flirting with the idea of recognition of the "TRNC" under the pressure from Ankara. The Republic of Cyprus should be prepared that with the defeat of Ukraine the power of this argument in different parts of the world will start waning very quickly. On the contrary, the victory of Ukraine will cement the new international norm of uncompromising intolerance for military invasions and illegal occupations, which will give impetus to the solution of many frozen conflicts in Europe in the first place.

### **Salvation lies within**

The three crises underlined the weaknesses and the vulnerabilities Cyprus will be facing in the foreseeable future. All the negative factors will remain and bear the risk of deterioration as long as the country does not reform. This is a monumental task to accomplish, especially, given the deterioration of the international economic and security environment. The efforts by the consecutive governments produced no very significant results so far.

Any initiative to reform a particular economic sector and attract investors was often accompanied by a pompous declaration to turn the island in no less than a specialized international hub. Over the years, such declarations gave the word "hub" a very specific sarcastic meaning among the Cypriots, which illustrates the lack of practical results.

This is not the time to criticise the previous efforts but the moment to understand the root causes of failures and redefine the approach to reforms. The first step is to understand the model, the second, the environment in which the model exists and operates. And the third is to understand what represents the *object of competition* in the modern world, which defines the parameters of success and the level of development.

*The root cause of the failed reforms was the wrong identification of the object the country must compete for.* And this is not the investment capital, which is currently almost unlimited in the world system, these are not the natural resources, which are abundant, and these are not the technologies, which can be easily purchased on the market (especially, if the country is part of the first world).

The main object of competition in the modern world is *the efficiency of the state institutional organization and administration*. The profitability of the country will increasingly be defined by the efficiency and effectiveness of its institutions. The efficiency of the institutions will define the capacity of the country to absorb the investment capital and the speed, to turn it over inside the system. There is proven

direct correlation between the cost of capital a government pays on its debt and the level of efficiency and trust for the state administration system. The richest countries in the world are those, which are the best organized and practice the most efficient governance technologies.

Therefore, the competitive advantage of any country is the level of efficiency of its institutions, which represents the economic immune system. The strength and the efficiency define not only the profitability but also the capacity to withstand the crisis. In other words, the more efficient will always be able to dump the crisis on a less efficient player and reap the benefits of competition in any sphere. Thus, the weakest and the least efficient institutional system will always be the "consumer of all crises".

The Cypriot government (current and future) must realise that the success of the country in the modern world starts not from the running after the investor's money or natural resources hidden deep in the sea but from the drastic restructuring of the administration system and of the governance techniques. Once the core problem is fixed, the rest will fall into place on its own, and there will be no shortage of investors queuing in front of the door. Till then, "failure" will remain the name of the game. As Mahatma Ghandi said: "speed is irrelevant if you are going in the wrong direction".