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IF THE DISASTER IS COMING, WHY NOT TO MAKE A LIVING OUT OF IT?

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The great French Marshall Lyautey once asked his gardener to plant a tree. The gardner objected that the tree was slow growing and wouldn't reach maturity for 100 years. The Marshall replied, "In that case, there is no time to lose; plant it this afternoon!"

From the speech of J.F. Kennedy

On the 5th of May 2023 the World Health Organization ended the COVID-19 emergency stating that it no longer constitutes the public health emergency of international concern. The pandemic happened to be the world's single biggest disruption since the WW2, which tested to the limits the preparedness and the resilience capacity of the system at national and international levels. It also uncovered the ugly truth about the lack of individual, collective or inter-state solidarity at the time of urgent need, disrespect for national and international laws/regulations, chauvinism and hatred for "others", i.e. the nationalism of exclusion. It clearly demonstrated the fragility, fragmentation, divisions and disbalances within the existing global system as well as the degree of unpreparedness, managerial and administrative incompetence at all levels. The pandemic became the turning point for relentless globalisation that lasted over three decades. Lockdowns, quickly-erected barriers and disrupted global supply chains gave birth to the reverse trend: *de-globalisation and reshoring*.

Once the deadly risk of COVID began subsiding, the sanitary disruption was followed by the military one: the Russian invasion of Ukraine, which will be remembered as the start of the new era in geopolitics and geoeconomics. The war is far from over but it has already cemented the deep rift between the collective West on one side, China, Russia and few of their closest allies on the other as well as identified a very large and diverse group of the so-called "non-aligned" states, which resist taking sides and prefer self-centred transactional relations with all players across the divide line. No matter the outcome, the war set in motion major trends that will define, at least, the next ten to fifteen years. Apart from the re-invigorated tit-for-tat sanctions politics, which added to the turbulences on the

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energy and commodity markets, there is another more significant destructive factor: *after more than thirty years of relative stability the invasion has revived the war as an instrument in the inter-state competition*.

The fiscal and monetary measures introduced across the board during the pandemic coupled with the disruptions caused by the war have brought inflation back into the game. This left no choice to the Federal Reserve, the ECB and some other major central banks but to start aggressively raising interest rates. After one and a half years of rate hiking policy, inflation began demonstrating a downward trend. The policy choice always comes at a price: the regulators face the dilemma balancing between the price and the financial stability. The central banks have now become the target for criticism from all sides. They are blamed for raising interest rates too fast, which might provoke the cascading bankruptcies, defaults and a severe recession, they are blamed for issuing and injecting too much of liquidity during the pandemic, which led to high inflation, and finally, they are blamed for mismanagement of the 2008 financial crisis and for over a decade-long zero-interest-rate policy, which ended in a massive accumulation of debt by governments and the private sector all around the world, but primarily in West Europe and North America.

The arguments about the risks posed by fast-rising interest rates, excessive debt, large-scale bankruptcies and a consequent deep global recession may sound logical and have some validity. At the same time, the policy responses by the major central banks at each stage since 2008 were mainly adequate and had few or no alternatives under the circumstances. The regulators must be credited for stabilising the financial system relatively quickly through the massive injection of liquidity, thereby saving the world from the devastating global depression with the unpredictable social and political consequences. The QE programs, which followed the crisis and lasted practically the whole decade before the pandemic, helped to fight persistent deflationary pressure and generate the nominal growth rate averaging between 2%-3% per year without any severe economic downturns. Contrary to the argument of the mainstream economic theories that the injection of liquidity coupled with the zero interest rate policy would provoke hyper-inflation, nothing of the sort happened thanks to the skilful financial sterilization conducted by the major central banks. Despite the multi-year efforts to stimulate the price increases, inflation remained anaemic and hovered far below the target levels of 2%, which naturally left no other choice but to continue the ultra-soft monetary policy. The longest recession-free period in the modern history was abruptly ended by the pandemic, statistically a relatively low-probability risk scenario that caught the world off-guard. And again, when the whole global economy was brought to a halt, the crucial role the monetary authorities played in keeping the system afloat was difficult to overestimate – they happened to be the best prepared and the best organized to face the emergency compared to the sanitary and the political authorities. It is important to note that since the crisis of 2008 the world was already living in the new reality of the *centrality of central banks.* The governments (especially in the Western world) led by politicians like to take credit for the financial support measures they rolled out during the pandemic without specifying that they could act mainly within the corridor defined by the central banks through the programs of injection of liquidity. However, the pandemic put the central banks in front of the challenge with the long-term consequences: *the unprecedented amount of the injected liquidity couldn't be efficiently sterilized through the financial sector as before because it had to be distributed directly to the locked down consumers and businesses, thereby opening the door to the uncontrolled rise of consumer inflation*. The disruption of the energy, food and other commodity markets caused by the invasion of Ukraine, and the anti-Russian sanctions that followed, only aggravated the situation.

It was necessary to elaborate in more detail on the monetary policy after the Great Recession of 2008 and the role the central banks played because of the nature and the complexity of the crisis the world is facing today and will have to deal with for many years to come. This is the risk of what is increasingly being called the *cascading crises*, i.e. when the crises in different spheres develop simultaneously in different parts of the world, then spread across the borders and reinforce each other with the unpredictable dynamics. This is what Mervyn King, former head of the Bank of England, once called "the radical uncertainty". Both the pandemic and the war in Ukraine were not the root causes of the crises we are facing but rather the trigger that broke the fragile balance. The previous decade may have been the longest recession-free period that nominally demonstrated growth. However, in *real* terms the combination of the key economic parameters clearly indicated at stagnation, and even this result was achieved thanks to the continuous massive injection of liquidity when the Fed and the ECB (let alone other major central banks) conducted seven QE programs over the decade, thereby keeping the system from falling into the deflationary crisis. The most recent IMF/World Bank forecast for the years 2023 and 2024 puts the *nominal* global economic growth at below 3% with the negative outlook. This is the lowest projection for the world economy over the last thirty years.

It must be honestly admitted that since the Great Recession of 2008 the world is living in the new reality of the <u>*long-term stagnation*</u>. It is relatively safe to assume that the regulators could continue keeping the economy in the "muddling through" mode for some indefinite period of time – anaemic inflation, zero interest rate levels coupled with the relatively stable geopolitical environment were giving some room for manoeuvring. However, the runaway inflation and the urgent need to aggressively raise the interest rates together with the deepening fragmentation of the global economy and the intensifying international security confrontation have put the world in front of the mutually-reinforcing multidimensional crises in the financial, economic, technological, social and geopolitical domains. To add insult to the injury, all that will unavoidably be aggravated by the ongoing climate change, regional demographic disbalances and uncontrolled migration waves.

Although the ongoing war in Ukraine and the recent pandemic took lives of millions of people, and triggered the biggest geoeconomic and geopolitical destabilisation, at least, since the end of the Cold War, nobody should have illusions about the long-term devastating effects of the stagnation, which gradually but inadvertently corrodes the very fabric of life of the modern world – the world, whose financial, economic, technological, social and political architecture was built on the assumption that in the long run *growth* is a continuous phenomenon. It is vital to remind ourselves that in historical terms growth is a relatively recent experience that began roughly with the birth of capitalism, and accelerated during the age of the industrial revolution. For many centuries before that the world was living in the environment of a continuous stagnation. In simple terms, *economic growth means the creation of wealth and the rise in the societal prosperity*. Unfortunately, this is exactly what was not happening over, at least, the last decade and a half, and the reality check does not instil much of optimism. There is still a lot of talk about the IT industry taking the world into the bright future, billions are invested in the digitalisation, every second or third hi-tech product is dubbed "revolutionary", the words "innovation" or "start-up" have attained the status of the religious mantra and are present in the speech of every self-respecting politician, business executive or ambitious economic development program. And for those, who did not notice, while the central banks were trying to contain the deflationary crisis over the whole previous decade, we were introduced to two Industrial Revolutions: Jeremy Rifkin introduced us to the Third Industrial Revolution in 2011, and Charles Schwab already to the Fourth some five short years later.

The purpose of this essay is not to spread panic or the message of the upcoming apocalypse, neither it is to mock the IT sector or downplay the importance of the technological progress. This text is the reflection on the societal prosperity, the common good, the wealth creation, why it is being eroded, how to preserve it, and most importantly, what it means for Cyprus and its economic model.

The main objective of any technology is the improvement in the quality of our life and prosperity. In the professional language it means generation of *gains in economic productivity*, one of the principal drivers of healthy sustainable economic growth, hence, the creation of wealth. Thus, in advanced economies, total factor productivity was around 2% a year in the 1960s. Since then, it has averaged closer to 1%; since the financial crisis it has been closer to zero. Tempting as it may be to blame the banks, productivity growth stalled before the financial crisis, not afterwards: the promised benefits of the IT revolution petered out by around 2006.[1] Robert Solow, the Nobel Prize laureate, who since 1980s was researching impact of computerization on the economy, insists that the internet has not had much impact on productivity. A detailed analysis of the technological progress is outside the scope of this paper, however, there is no doubt that the inventions of the so-called Information Age (personal computers, mobile communication, the internet etc.) had a much lower positive economic and societal impact compared to the technologies of previous generations such as the gas turbine, the electricity, the automobile, the refrigerator or the airplane and many others that were invented in late 19th- early 20th century. It is also a well-known fact that the rate of discoveries in fundamental sciences peaked by the early 1960s and was declining ever since. The core technology behind the Information Age industries is a microchip that was invented back in 1958. It is now increasingly believed that the microchip-based technological platforms reached their saturation stage, and therefore we observe their ever diminishing impact on productivity, hence, the economic growth. Massive layoffs across the tech industry in the US and Europe

[1] Harford, T., *We Still Waiting for the Robot Revolution*, 4 August 2017, downloaded from www.timharford.com

in recent months as well as the growing number of bankruptcies in the Silicon Valley is another confirmation that the effects of stagnation have finally reached the segment of the economy that was considered immune to the struggles of the rest of the system.

Since the introduction of ChatGPT to the market late last year, the Artificial Intelligence (AI) has now become the focal point of the technological debate. There is no doubt that this technology has the potential to impact the world like no other over the last seventy-eighty years. However, at this stage the key word is the “potential”, which is not yet the reality. The vivid debate around the AI ranges from the optimistic exultation to catastrophic projections of the inevitable Armageddon. This is a natural process, since the technology is still at its infancy, and its real impact will not be known for quite some time. Nevertheless, there is already a consensus expert opinion that the first negatively-affected sectors, where the AI will automate many of the functions will be the accounting and finance, tax preparation, banking, insurance and, surprisingly, the public sector jobs. Given the role these industries play in the Cypriot economy, the risks are obvious and should not be underestimated.

The AI together with the genetic engineering and other biotechnologies stand at the heart of the promised Fourth Industrial Revolution. Schwab reckons that it will combine the physical, digital and biological worlds. According to him, it will impact all disciplines, economies and industries, and even will challenge our ideas about what it means to be human. These projections have some tangible scientific progress and investments behind it. However, when industrial “revolutions” are discussed, one should always consider the following: *the rate of failure; time horizon; financial viability and diffusion across the economy*. There were hundreds of “mega-historical-revolutionary” technologies that were promised ages ago but never took off: fast breeder reactor; thermonuclear energy; magnetic levitation train and so on. It took coal roughly over a century before it gradually became the primary energy source of the Industrial Age. The Concorde supersonic passenger plane was abandoned without ever generating a penny of net income – so expensive it was to operate. This is a classic example of a promising technology unable to fit in the harsh reality of the economic environment. And finally, the most important factor of all is the potential for diffusion across the economy with the positive sustainable impact on productivity and societal prosperity. This is where the main uncertainty and the controversy arises: what comes first, the technology or the growth? The current mainstream economic theory reckons that the breakthrough technology comes first, then it spreads across the economy and generates growth. This philosophy is the cornerstone of any governmental strategic development program, which fashionably prioritizes stimulation of “innovations” and “start-ups”. The opposite view argues that no technology would ever take off, if the timing and other critical factors such as demographic, social, industrial, financial and demand conditions are inappropriate*. In other words, it is “the total package” that counts – it creates the right conditions in organization, production and distribution to help the technology to spread through the economy.* Given the available data on the effects of computerization and the internet on productivity, it is legitimate to question what was actually behind the economic growth and the rise in prosperity during the so-called Information Age since the early 1980s. *Were the steve jobses, the intels or the microsofts of the world driving us forward or were they simply riding on the wave of economic expansion created by other more powerful historical forces?* There is no doubt that the Information Age industries made their positive contribution to the rise in prosperity, job creation and economic growth. However, there were other more fundamental economic and geopolitical processes that created the environment within which the new technologies took off and flourished - most importantly, they created the demand and expanded the boundaries of diffusion.

In a disparate attempt to restart the US economy after the decade of stagflation (in the 1970s), the Fed and the Reagan Administration launched the program of financial de-regulation and liberalization that put the banking and finance industry (which was always considered "boring and uneventful") in the driving seat. Simultaneously, the collapse of the communist block and the opening of China transformed what was initially the local and later regional (Western) process into the financial globalization. The unprecedented rise of the global finance industry and the international trade created the urgent need for principally new and faster communication networks and tools on a planetary level, hence, the demand and the spread of personal computers, mobile phones and the internet.

The understanding of the principal that it is the global social-economic and geopolitical context that creates the wave of demand, stimulates or kills certain technologies, industries or national economies and not the other way round is critical because its importance goes far beyond the theoretical academic debate – it is the matter of success or failure not only for the individual entrepreneurs and corporations but for the whole countries. And this is where the case of Cyprus is very illustrative. A once impoverished country, without any specifically valuable technological, financial or natural resources, found itself in the right place at the right moment and became one of the biggest beneficiaries of several historical processes simultaneously. *The Cypriot economic model and its decades-long success was the direct product of globalization and offshoring.* It is important to clearly understand the mechanism of success in order to pave the road forward and avoid falling victim of de-globalization, reshoring, technological and geopolitical de-coupling.

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 capital 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 Green Line. The status-quo and 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. 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, 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.

Nevertheless, 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. 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.

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. <u>*The era that lasted roughly forty years, is over now*</u>. Ironically enough, but there is a lot of symbolism in the recent saga around the US/UK-imposed sanctions against the Cypriot legal and corporate providers that allegedly helped the Russian capital to flow through the newly-erected Iron Curtain. *It is the symbolic requiem not only to the era that is leaving the stage of history but also to the Cypriot economic model that rose on the back of the globalization, started in the United States, by successfully exploiting the British-*

inherited legal/financial/administrative system, through which it was channeling billions flowing out of Russia in the age of peace, prosperity and openness. It is the signal that it is time to act and search for a new model. 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.

If the disaster is coming, why not to make a living out of it?

It is clear today that the economic stagnation, the pandemic and the war in Ukraine inaugurated the new period of the unpredictable mutually-reinforcing dynamics of 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 Russian invasion put an end to the post WW2 order based on the principals of territorial integrity and sovereignty of the nations-states, and the prevalence of the international law. 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 coupled with the ongoing climate change and demographic disbalances between the global South and the global North creates the risk of the *cascading crises* mentioned earlier.

The post WW2 political and institutional system was also helping the Republic of Cyprus to successfully appeal and block the recognition of the "TRNC", since the majority of countries adhered to the international norms and respected the UN resolutions on the Turkish invasion of the island. In the emerging environment of geopolitical erosion and decompression not only the international laws and regulations will increasingly be ignored, but many countries in different parts of the world will have to pass the test of times and defend their right for existence on the political map of world. The war in Ethiopia followed by the drought and the risk of famine, the intensifying conflict in Sudan are just two of the recent examples. Egypt is constantly balancing on the brink of implosion. The negative effects of the economic stagnation threaten the developing world more than the rich one. It is *vital to understand 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.* The pandemic and the war in Ukraine only aggravated the situation. The disrupted supply chains, rising energy prices and food shortages elevated the risk of implosion in many countries, especially, across Africa and the Middle East. These regions experience active demographic growth. For comparison, the average fertility rate across the EU is 1.4-1.5 against the factor of 5 in sub-Saharan Africa. Up to 40% of the Middle Eastern population are people under the age of thirty. At the same time, the Middle East is becoming the hottest region on planet suffering from the increasingly acute shortages of water and arable land degradation, which will be the driving factors behind the migration waves from the region for many years to come. Climate change, overpopulation, very vulnerable economic structures will deepen the religious and ethnic tensions as well as the risk of the institutional collapse in many countries. The region will remain the area of protracted violence and humanitarian tragedy for a long time. Unfortunately, it is not the only one. The Russian invasion of Ukraine opened the door to the destabilization of the whole post-Soviet space from Eastern Europe to the Caucasus, Central Asia and the Far East. After fourteen months the war has come to the territory of Russia proper. The recent drone attacks on Moscow became the first military incident around the Russian capital since the WW2. The outcome of the war is unknown yet, so is the future of the Russian Federation itself. No doubt the unsuccessful invasion will end in deep internal political crisis with multiple exit scenarios ranging from the civil war to partial disintegration. The political and military vacuum left by Russia in the post-Soviet space and parts of the Middle East is already being filled by China, which dramatically changes the geopolitical configuration across the Eurasian landmass that existed, at least, since the beginning of the twentieth century. China’s assertion will intensify competition with the West that will only deepen the ongoing technological and economic de-coupling bringing more fragmentation and instability to the global geoeconomic and geopolitical landscape, including hostile competition in the cyber and the outer space.

In Europe, apart from the risks stemming from the stagnation and the geopolitical confrontation described above, there is one specific matter of concern everybody should pay attention to - it is the state of affairs in Germany, Europe's largest economy that was playing the role of the block's leader and economic locomotive over the recent decades. Germany, like most of the European economies, has reached the point of the demographic cliff. The generation of baby boomers, whose borrowing and spending capacity was driving the economy in the age of globalization, is finally retiring en mass this decade. The process will naturally have direct negative repercussions for both Germany (that will see substantial increase in social spending on pensioners, who enjoy now much longer lives) and the rest of Europe that was heavily dependent on the German economy pulling the continent forward. The low fertility rates and quickly aging population will have impact on stagnant productivity as well as the domestic and European patterns of consumption. On top of that, there are concerns regarding the competitiveness of some of Germany's critical industries as a result of the delayed reforms and under investment in the previous years.

The EU is operating by 7-year budgetary cycles. This is when the money is distributed among the member states. It is clear that given the deteriorating state of affairs in the richest donor countries, the next budget 2027 will see many cost-cutting measures introduced that will directly affect the subsidies and the development funds to the net beneficiary countries like Cyprus. That might strengthen even further the already high disapproval ratings of the European Union among the Cypriots. According to several recent polls by Eurobarometer, Cyprus has the highest share of those, who blame the EU policies for the worsening of their purchasing power. The Cypriots are also among the top three nations in the block with the highest disapproval of the European policy on Russia. The negative sentiments are reinforced by what is viewed in Cyprus as the inability and the unwillingness of the EU to put pressure on Turkey with regards to the solution of the Cyprob.

Bitter feelings of the ordinary people are understandable – some have lost jobs and income as a result of the anti-Russian sanctions. At the same time, it is the responsibility of the expert community, business executives, government officials and other opinion makers to explain to the general public that despite some losses related to the sanctions, *membership in the EU is a strategic economic and geopolitical benefit to the Republic, and actually, is <u>the biggest asset the country has</u> with the net tangible financial, material, security and political gains that far outweigh the perceived negatives. The value of this membership will be appreciating by day as the global geoeconomic and geopolitical turbulences will intensify before the clear contours of the new architecture will emerge, and the system will start gradually stabilizing*. *This process probably will take up two decades.* Apart from the net subsidies, rescue and development funds, the membership, first and foremost, defines the status of Cyprus on the global political and economic arena as the country of the *first world* that in itself serves as the "quality label" of the highest order with all the relevant investment benefits and opportunities. The membership in the euro zone provides the valuation of the national economy and of the personal assets in one of the two global reserve currencies, but even more importantly, it brings the country under the umbrella of the ECB, second most powerful after the Fed monetary stimulation and stabilization institution in the world, whose role will only be growing for years to come. Cypriots with strong anti-EU sentiments should take a look at post-Brexit Britain and all the "benefits" it enjoys outside the block. And this is not a small peripheral economy Cyprus is, but a G7 member country.

Cyprus today, like no other country in the EU, has reached the turning point and stands in front of the challenges of historical scale, when it is obliged to re-invent itself in order to preserve what was achieved over the last four decades, and secure the long-term continuity of both the Republic and its prosperity. This is a monumental task that requires a strong societal consensus on the following*: in the new era of de-globalization, de-coupling and polarization the country's place should uncompromisingly be in the Western camp*. The ideas of "non-alignment" or the Soviet-imported "socialism with the Cypriot face" must be left behind forever and vanish in the twentieth century, when the geopolitical reality obliged a young and inexperienced state to balance between the camps. The diverse club of countries unwilling taking sides in the emerging global rift, unfortunately, is primarily made of poor and relatively underdeveloped economies. If Cyprus fails to preserve its prosperity and invent the new economic model, the place in the club will be waiting for it. The Soviet era (ideas, mentality, technology, military know-how and hardware) is finally dying in front of our eyes on the battle fields of Ukraine.

Cyprus must preserve its hard-earned place in the *first world* by any means, and should not take it for granted. The West, and the European Union in particular, is not a charity club and membership is not a free ride. The Western countries may share the common values, but fiercely compete against each other for ever shrinking resources in pursuit of the self-interest. It is highly probable that frictions inside the Union will intensify in the coming years due to the stagnation and other social-economic reasons mentioned earlier as well as because of the disagreements over the issues of common foreign and defense policy. The attempts by the consecutive Cypriot governments to put the Cyprob on the EU foreign policy agenda have brought no fruit. The local political establishment should give up on the illusionary idea that the block can possibly pressure Ankara to dramatically change its stance on the Problem, let alone introduce any sanctions against Turkey on that matter. Cyprus should expect direct and active involvement of the EU and of the collective West on its side only in case of the risk of military confrontation. Given the peaceful nature of the conflict (which is already a unique achievement in itself that nobody should take for granted!) and the multiple failed attempts to reach the solution, it should be realistically admitted that the Cyprus problem stands low on the priority list of the European agenda. As for Turkey, given the important role it plays in the context of the ongoing war in the Ukraine, and especially, in view of the tectonic geopolitical shifts that began taking place from the Black Sea region to the South Caucasus and to the whole of the post-Soviet space, its influence will only be growing, and the West will be seeking cooperation with Ankara.

No matter how controversial it may sound at first, but the Cypriot society and its establishment should re-evaluate the priorities in the context of the dramatic challenges that were described in this essay. Cyprus must focus on the *search of the new economic model and build a strong resilience capacity* in view of the risk of the cascading crises the country may have to face. It should seek deeper economic, technological and military ties with the collective West in order to finally become a fully integrated part of it. The Cypriot economy must climb up the ladder and develop industries with high knowledge and technological intensity.

Calling for transformation is easy. Developing a plan and rolling it out is the difficult part. For any new knowledge-intensive sector to take off in Cyprus, two conditions must be met: *massive capital investments, and a high concentration of technical expertise in a particular sector*. The country lacks both. The role of the government is to correctly evaluate the environment, identify the emerging trends and create the “fertile soil” for an industry to emerge and grow.

The Cyprus government should take a closer look at one particular phenomena, the force that is already playing a growing role in the world affairs at all levels, it is capable of setting the international agenda, influencing the public opinion and pressuring the state authorities, it possesses influence and has access to significant financial and other material resources. This force is made of multiple players, small and big ones, and the majority of them are coming from the wealthiest Western countries. They are called the *not-for-profit NGOs* or the non-state actors.

Given the country's geographic proximity to the major risk zones of the Middle East, Africa and Southern Asia, and the array of demographic, social-economic, military and environmental challenges they face, as a first step, Cyprus should consider catering itself to the international *medical, environmental, relief and disaster management NGOs* as their regional or international administration and logistical center. No matter how cynical that may sound, but unfortunately, the number of humanitarian tragedies is expected to rise during the ongoing global paradigm shift. Cyprus possesses a modern logistical and communication infrastructure, internal stability, safety and a relatively low cost of operations. The government must develop a package of incentives as well as undertake a targeted "diplomatic offensive" to attract such entities from all around the world to open their regional and international offices on the island. That should include administrative and medical personnel, logistical operations via local ports/airports and storage of aid inventory/supplies, and probably their training facilities as well.

As a second step, the NGOs must be provided with the incentives and assistance to open on the island *medical rehabilitation centres and sanatoriums*, where patients (victims of wars and catastrophes) will be brought for treatment. The NGOs have access to multi-billion donor resources from all around the world (private, corporate, national and inter-governmental). Operations of medical rehabilitation centres in such a case will be financed by the *not-for-profit capital* of donors. The NGO sector has one significant advantage over the private one - its operations do not depend on profitability and stock market crashes, they do not close their operations when disaster strikes. On the contrary, their activities only intensify during the periods of instability. Thereby, Cyprus could create additional industry with the "counter-cyclical" economic characteristic. Apart from the income the country could generate from the presence of the NGO offices, personnel and logistical operations, the main objective is to create "fertile soil" for medical services industry and related sectors to take-off on the island. The country has no enough available capital to invest on its own and it is not a competitive destination for investors in medical sector due to the lack of large-scale concentrated medical expertise. For this industry to take-off, the main condition must be met: *large concentration of <u>doctors, nurses and patients</u>.* Medical relief NGOs by opening rehabilitation centres on the island, financed by not-for-profit capital could help the country to create the "fertile soil" for the sector. Concentration of the medical expertise, infrastructure and patients, at a later stage, will inevitably start attracting private capital, pharmaceutical and medical supplies companies as well as private investments in related segments, which will be developing as a spin-off such as laboratories, R & D activities, medical services and equipment manufacturing. Cyprus could have a chance to become a specialized center in the field of *conflict and catastrophe medicine*, which would help the country to push its economy further up the value chain and drive deeper technological transformation in others sectors.

Apart from the purely economic objectives, attracting and creating a high concentration of the international NGOs on the island has other equally important dimensions. The main reason for consecutive failures of the Cypriot governments to advance the country's agenda internationally remains the lack of strong allies in the most important capitals of Europe, America and the rest of the world, allies capable of influencing the domestic public opinions and pressuring the local governments from inside. There is a unanimous consensus that the role of the non-state actors, NGOs and other activist groups, will be growing substantially both at the national and international levels. Some of them possess multi-billion funds and exert enormous influence in places like Washington DC, Brussels and other major capitals. Cyprus must focus on building the relations with multiple and diverse NGOs and other non-state activist groups in order gain their support and turn them into its allies.

The country was fortunate enough to have stability and peace on the divide line over the whole period of the conflict. However, nobody should forget that the war always remains the bottom-line security consideration that must be avoided at all cost. High concentration of medical and disaster relief organizations, rehabilitation centers, sanatoriums and inventory supplies on the island will automatically integrate the country into the global network of strategically-important humanitarian and relief operations. Any military attack against such facilities with human casualties will be considered as an international war crime. Given the power of the NGOs and that of their donors, their influence on the media, public opinion and governments in their respective home countries and internationally, Cyprus can and should turn their presence on the island into its own alternative and efficient defense capability.

The Republic of Cyprus should pursue the following foreign and defense policy dictum:

- DEPRIVE TURKEY OF THE INCENTIVE TO ATTACK

- DEPRIVE THE INTERNATIONAL COMMUNITY OF THE RIGHT TO KEEP SILENCE AND TAKE NO ACTION