THE EMU, INTERNATIONAL CONFLICT AND THE CASE OF CYPRUS

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Cypriots were fully aware of the serious problems of their economy and that the inevitable bail out agreement was going to be austere. But they did not expect the harshness of the whole package. In reality what has happened is an attack on Cyprus which takes the country back decades.

Undoubtedly Cyprus has been facing structural problems; but there was a willingness to address them substantively. Fiscal rationalization had started in December 2012. And the new government which took over on March 2 did want to push further. Eventually the political climate on the island was such that the people were prepared for a gradual paradigm shift. In this effort Cyprus had expected the solidarity of the Eurogroup and above all Berlin. Instead there was an unprecedented attack bordering on robbery which raises serious questions about the existing value system in the EU. Inevitably there are serious disruptions on all aspects of life.

The relentlessness of the measures is such that it amounts to an attack on Cyprus. It seems like a well-coordinated effort to strike down the economy of Cyprus and to contain relations with Russia. On top of this from a purely economic perspective what has been done does not make any sense! With a gradualist approach the problems would have been resolved relatively quickly. But as things stand a necessary condition for economic recovery is temporary exit from the Eurozone and the return to the Cyprus Pound (or the Cyprus Euro).

Feldstein (EMU AND INTERNATIONAL CONFLICT (Foreign Affairs, vol. 76, no. 6, Nov./Dec. 1997, pp. 60-73) had predicted – it must be stressed in 1997 - that it was expected to have strains in the EMU due to the different economic structures of the participating countries as well as of their objectives. He had also indicated that in times of crisis the EMU would be facing serious challenges. The Eurozone debt crisis and the gap between the European North and the European South are indicative. What is even worse is the lack of a vision and a comprehensive economic strategy to get out of the negative vicious circle.

The tragic case of Cyprus also exemplifies the existing contradictions and the lack of the minimum level of solidarity for such a project. Given the architecture of the Eurozone and the philosophy of the Troika it will be extremely difficult for Cyprus to recover within the Eurozone. With the philosophy of the Troika it will be impossible to do so. Indeed what is required is a form of a Marshall Plan and an expansionary fiscal policy. Since these are not possible with the current architecture of the EMU the temporary exit from the Eurozone and the return to the pound seems to be the only pragmatic option.

Cypriots perceive that what has taken place amounts to collective punishment. The developments in the last weeks point clearly to the fact that the choice is not between staying in the Eurozone and returning to the pound. And this because it should be understood that with all measures on capital flows Cyprus is no longer an equitable member of the Eurozone. In the immediate aftermath of 1974 restrictions on capital flows essentially entailed controls in relation to foreign transactions. There were no controls in relation to internal transactions. The tragic element today is that the controls are strangling the market they are trying to save.

It should also not escape our attention that over time severe misperceptions were created about Cyprus; that it was a money laundering centre, a casino economy, and above all that it was a state that caused the EU recurring headaches. It also seems that some circles in the EU had held a grudge that in 2004 the Greek Cypriots had rejected the UN plan for the solution of the Cyprus Problem. As if in a referendum we have to vote what others think is good for us!

Cyprus indeed has very serious problems and decisions taken were/are on several occasions clumsy; not to ignore the fact that Cyprus itself has no narrative to project internationally.

But it is now emerging that the Eurogroup’s vindictiveness against Cyprus is beginning to backfire. This is not only an attack on Cyprus; it undermines the entire concept of the euro and worse still of all modern banking systems which are based on fractional reserves for banks, backed by one or another form of governmental guarantee. Already it has been reported that this year European banking would lose about €15 billion deposits. It remains to be seen how this will end.

Undoubtedly Cyprus will suffer and sooner or later the country will have to opt to temporarily return to its national currency, the Pound (which would in essence be the Cypriot Euro). The earliest this is done the better it would be for the prospects of creating the preconditions for putting an end to the depression. As far as the Eurozone is concerned it seems that if there is no change of philosophy and economic directions other countries will follow Cyprus accordingly.