Cyprus bailout; no end in sight for Eurozone crisis? does it signal a new direction?

Andy Yorke Tue, 07/05/2013 - 07:17
Andy Yorke

The vote was close on Tuesday 30 April as a €23 billion bailout deal scraped through the Cypriot House of Representatives in Nicosia with a two vote majority. The deal, stitched together by the ?Troika? of the European Union, European Central Bank (ECB) and International Monetary Fund bureaucrats, provides €10bn in EU and IMF funds on condition of €13 billion in cuts by the Cypriot government. Its main priorities are to recapitalise the banking system (€2.5 bn) and pay off government debts to international bankers and bondholders that fall due up to 2016 (€4.1bn).

Yannakis Omirou, president of parliament and head of the reformist EDEK (Movement for Social Democracy) reacted to the news with anger: "Instead of solidarity from our European partners we have been served poison". Giorgos Doulouka, spokesman of the main opposition party, the post-Stalinist AKEL: "They are eating us alive. What Greece suffered in three years, Cyprus is experiencing in a matter of weeks.? The cuts will bite deep; €23 billion is more than an entire year's GDP and the Cypriot economy is expected to contract by a huge thirteen percent over the next year. That trend is unlikely to change in coming years, despite optimistic predictions of a return to feeble growth in 2015.

Poisoned neoliberal paradise

Cyprus found a specialised niche in the neoliberal, finance-driven world of globalisation and then in the Eurozone, which it joined in 2008. Its economy was rooted in tourism, which fuelled a huge property boom and a speculative bubble. It also became an ?offshore banking centre?, that is, a secretive tax haven with a ten percent corporate tax rate, the lowest in the OECD. As much as €20bn, thirty percent of Cypriot banks' assets, came from the corrupt Russian elite, oligarchs and mafia alike, who fleece Russia of its wealth and then hoard their millions abroad. By 2011, the IMF reported that Cypriot bank assets, meaning mainly the loans made by the banks, were equivalent to 835% of annual GDP, one of the highest ratios in the European Union.

Cypriot banks were hit hard by the Greek sovereign debt crisis in 2010. Loans made to Greece were the equivalent of 160% of Cypriot GDP, too big for the Cypriot government to cover. International loans to the government dried up, shutting Cyprus out of international loan markets for the last two years. Then, the second Greek bailout last year created another crisis, as Cypriot banks were forced by the Troika-brokered deal to take a ?haircut?,that is, or enforced losses, on their investments. The AKEL-led government of the time had done nothing to deal with the growing financial crisis, relying on a €2.5bn loan from Russia and resorting to unsustainable policies, such as taking loans from state-owned companies to pay state employees, that only made the debt worse.

AKEL?s Demetris Christofias, president of Cyprus for five years, effectively admitted his party's failure, saying he would not be seeking reelection because ?the Cyprus problem has not been solved and it does not seem possible to achieve decisive progress during the next months?. So much for the fighting leadership of the ?progressive working people? of the party?s title and the only ?communist? head of state in the EU! Under Christofias, the AKEL-led coalition cut civil service jobs, introduced VAT on food and drink, and allowed unemployment to rise. This openly anti-working class policy resulted in the narrow election of Nicos Anastasiades from the rightwing Democratic Rally Party (DISY) as president on 24 February this year. Anastasiades from the beginning campaigned for a change of direction, for a programme of neo-liberal ?structural reforms? and cuts, as part of a bailout from the EU to restore Cyprus?
solvency, signalling a shift from Russia towards the EU.

Economic stagnation finally turned into financial meltdown in March this year. On 15 March, the government was forced to close the country’s two biggest banks, the Bank of Cyprus and the Popular Bank of Cyprus (Laiki) to prevent panicked depositors withdrawing their money. Originally, the government agreed to a bailout deal which would have seized up to ten percent of depositors' savings. This included a 6.7 percent levy on the mass of savers depositing less than €100,000 which are supposedly state-insured deposits under EU law. Anastiades said he had no choice but to accept these terms, but escalating protests forced Parliament to throw out the agreement and negotiations began again. Despite the huge Russian deposits, appeals by the pro-EU Anastiades government to President Putin for aid were ignored.

Finally, the ECB weighed in, warning that if no bailout were agreed with the EU and IMF by 25 March it would cut off its emergency liquidity assistance to Cyprus. In Brussels, Eurocrats threatened to withdraw support and force a ?disorderly default? and an exit from the Euro unless Cyprus signed up to the onerous terms. The bullying and wrangling went down to the wire, with a deal finally produced in the early hours of 25 March.

Recapitalising banks, pauperising the people

That deal will keep Cyprus in the Eurozone (for now) but, bowing to popular pressure, it will leave small deposits, under €100,000, untouched. However, the Cypriot people must still pay a heavy price. Laiki, the country’s second largest bank, will be shut and heavy losses will be loaded onto the big depositors whose €4.2bn in deposits will be sequestered into a ?bad bank?, along with the investment funds of shareholders and bondholders who will be wiped out. This is the first time holders of higher-rated bonds have faced such losses in a eurozone bailout.

Since Laiki was 84 percent owned by the Cypriot government, following a €1.8bn bailout in June 2012, the Cypriot people have already paid a large part of the failed bank’s debts. The Bank of Cyprus will now be forced to take on the €9bn debt Laiki had to the ECB. Thousands of bank workers from both banks will lose their jobs.

The Bank of Cyprus will continue to exist, shored up by the transfer of deposits from Laiki. No EU bailout funds will be used to recapitalise it. Instead, as with Laiki, big depositors will be ?bailed in? to aid the recapitalisation, after shareholders and bondholders who will be forced to take a major "haircut" of 40 percent or more.

As part of its recovery strategy, the Cypriot government has been forced to begin the sale of €400m of gold reserves. Coming as it does against a background of slowdowns in China and US, this has set off a global slide in the gold market and its price. Meanwhile, domestic creditors will have their loans rolled over, that is, payment pushed back, and the Russian loan will probably be renegotiated with lower interest and a longer maturity. In other words, the big EU powers are making sure that others are paying for the bulk of the bailout. A €1.4 billion privatisation programme will strip the state of its assets, selling them off to imperialist capital at attractive prices.

On that note, there is a new source of plunder for the EU carpetbaggers to pick over; the offshore Aphrodite gas field, believed to hold as much as 9 trillion cubic feet of gas, discovered in 2011, and part of the much larger Leviathan field. No doubt the austerity programme will be used as leverage by the newly influential Troika to control these precious new energy reserves, and keep out the Russians.

A zombie economy

Gross government debt is forecast to rise to 109% of GDP in 2013, to 123% in 2014, 126.3 in 2015 and then to begin slowly shrinking. Like the estimates of a return to growth in 2016, most economists openly disbelieve these figures. Similar projections in the past that papered over yawning, growing cracks in Greece, Spain and other bailed out countries, provide good grounds for pessimism. Not only are further holes likely to be found in the national accounts and its zombified banks, but new ones are likely to open up as the economy collapses and foreign deposits dry up or flee at the first opportunity.

Gary Jenkins of Swordfish Research said: "The economy is crushed for the next God knows how many years. As soon
as people can take their money out of the banks, they will take it out. Confidence has disappeared. Who's going to want to do business with Cypriot corporates right now?" The point was echoed by Simon Derrick, chief currency strategist at BNY Mellon "Why would confidence return and make people want to put money into Cyprus?" For the Cypriot people, this is a man-made economic disaster of historic proportions that will permanently alter the island's economic destiny.

For German and French imperialism, however, all this is merely unavoidable collateral damage in pursuit of their larger project, the Euro currency union. The Eurozone is a strategic basis for their economic and political power in the imperialist world system, under pressure from their bigger, and more competitive, US and Chinese rivals. To maintain their position, the working class in every Eurozone country must ?do their duty? to pay for the crisis with austerity, and allow a more profitable, competitive Eurozone to emerge. This is particularly true of those economies in danger of collapse that could take down the Euro with them; the poorer, smaller economies and even the likes of Spain and Italy.

As the ancient Greek historian, Thucydides, explained, in the context of the Athenian empire crushing the smaller island of Melos as part of its strategic struggle against Sparta: "The strong do as they can and the weak suffer what they must'. The same principle remains true in the imperialist epoch of capitalism, as the poor countries of the semi-colonial world bear the brunt of an austerity that has its origins in the crisis of profitability in the imperialist states and was triggered by the financial bubble and banks of the West.

A destabilising template for future bailouts?

A tremor went through the markets and investor blogosphere at the end of March when Jeroen Dijsselbloem, the Dutch chair of the Eurogroup of euro zone finance ministers, said that the Cyprus bailout could serve as a ?template? for future rescues. He argued that taxpayers should not have to pay to save risk-taking bankers (or feckless peoples like the Greeks, as the German and Dutch tabloid headlines scream). The bondholders and share-investors were appalled that they might have to pay the costs of their own bad investments!

The resulting furore forced Dijsselbloem to backtrack, saying that the particularities of each country would have to be taken into account, a position echoed by ECB bankers. But the damage was done even before he spoke, as the terms of the bailout, and their implications, became clear for the rest of the Eurozone. The European Commission and MEPs drafting new EU laws on resolving bank failures confirmed that proposals would include the "bail-ins" favoured by the solvent Northern European countries that are in the end bankrolling the bailouts.

However, when state bureaucracy meets market forces, it is ultimately the latter that win. No doubt rich depositors, with more than €100,000 parked in an Italian or Spanish bank, are already thinking about moving their money somewhere safer. As soon as rumours start about a bailout in another Eurozone country, depositors with less than €100,000 in the bank will recall what happened in Cyprus; banks closed, ATM?s empty and the threat of a tax on their deposits, and that could also start a run on the banks.

The Cyprus settlement, even if it is not a new template for bailouts, could hit ?investor sentiment? elsewhere in the EU, exacerbating the unending crisis situations in Greece, Spain and elsewhere, destabilising Ireland and Portugal just as their bailout terms are coming up for renegotiation. Already, investors are looking fearfully at Malta, with a bigger banking asset to GDP ratio than Cyprus, and Slovenia as the next candidates for a bailout. Whatever the finer details, the Cyprus settlement has set a precedent. Maybe Merkel, Hollande, Dijsselbloem, Draghi and Co. would not take such measures against Spain or Italy because of their ?particularities?, that is, their economic size and political importance. However, with only €500 billion, the European Stability Mechanism, the EU?s bailout fund, is too small to bail them out and, in a crisis, someone would have to pay for a return to even temporary stability. Bail-ins and steep haircuts for private investors might be the only way.

A second dangerous precedent set by the Cyprus settlement is the introduction of capital controls. If a Euro cannot be freely exchanged in Nicosia, then it is worth less than one in Germany that can be. This could lead to all sorts of financial manoeuvring and to flourishing black markets, that would further undermine the Euro. Article 63 of the Maastricht Treaty states that "all restrictions on the movement of capital between member states and between member
states and third countries shall be prohibited" unless there is an issue of "public security". However, there is no sign of anyone enforcing Article 63 if that means a run on the banks in Cyprus that could spill over into the rest of the Eurozone. If such measures become more widespread, it will increase the contradictions between the rich, creditor North and the crisis-hit, debtor South of the Eurozone, and further undermine the common currency.

No solution in a capitalist Cyprus

Left reformist leaders from AKEL and EDEK are starting to put forward the ?Iceland solution?, that is, leave the Euro and devalue the currency. But in Iceland the currency collapsed to half its value internationally, and average incomes fell by nearly a fifth. It is now growing and ?competitive? precisely because of the collapse of its currency and wages! This is a capitalist solution and not a better one either. Given the crisis situation in which the Cypriot Pound would be re-introduced, its value would be certain to plummet. That would automatically mean not only rapid inflation in the price of imported goods but also the inevitable sale of the island's resources and assets, no doubt including the offshore gas reserves, to those with the foreign currency to buy them at knock down prices. The end result would be little different, potentially worse, from the new government's neo-liberal strategy.

Just as AKEL and Demetrios Christos had no solution to the crisis when they were in power for five years, now, in opposition, they only put forward a different capitalist solution, rather than the programme of anti-capitalist measures that is needed. Such an emergency programme would start from the need to ensure the capitalists and imperialist banks that caused the crisis paid for it: repudiation of the debts, nationalisation of the banks and failing industries under workers' and consumers' control, and a democratic plan to centralise the resources of the economy, taking advantage of Cypriots' abundant skills in finance and administration, 32 percent of the population has a university degree, the second highest level in the EU, and using the gas reserves to pay for development. Ultimately, however, Cyprus' future cannot be separated from that of the rest of Europe and that would require the internationalisation of such policies as part of the struggle for the Socialist United States of Europe.

Source URL: http://www.fifthinternational.org/content/cyprus-bailout-no-end-sight-eurozone-crisis-%E2%80%93-does-it-signal-new-direction