



Cyprus: Crisis exit and fresh hope for reunification

As the fifth and final euro area country to receive a bailout package, the Mediterranean island Republic has followed in the footsteps of Ireland and Portugal by successfully exiting the three-year rescue programme that was agreed in March 2013. An ambitious reform agenda has been implemented, there is renewed growth and the island's reunification is again taking centre stage, with the possibility of an agreement that would bring an end to 42 years of division.

For many years, together with tourism, the banking sector drove the Cypriot economy. However, the 2009 financial crisis and the large-scale purchase of Greek bonds in 2010 brought the country to the verge of default and forced the government to urgently seek external assistance. After having first turned to Russia¹, Nicosia agreed to the terms of a European bailout programme.

Three years down the road, Cyprus's creditors have commended its exit from the programme. In its country report², the IMF concluded that "economic growth and fiscal outturns have continued to surpass expectations" and the EU noted, through Jeroen Dijsselbloem, Eurogroup President³, that "the commitment of the authorities and the Cypriot people to the overall programme agreements has also been essential to a fiscal performance that has exceeded expectations".

Direct contribution from citizens

Low taxes and banking secrecy contributed to making Cyprus a highly-coveted financial centre. This sector's activity represented seven times domestic GDP. As a result of very heavy investment in Greek debt, the two leading banks (Bank of Cyprus and Laiki Bank) were brought to the brink of insolvency. As the country went into recession, the government assessed its requirements at €17 billion⁴.

In accordance with the provisions of the new European Stability Mechanism⁵, the ECB, EU and IMF put a joint €10 billion deal on the table (amount required to recapitalise the banks) in return for the government rolling out the structural reforms required for fiscal consolidation. Talks lasted almost six months before a compromise with the creditors was reached.

The main stumbling block was the introduction of a tax on bank deposits, which was a first for the EU⁶, together with capital controls. Having been initially requested by the Eurogroup, taxation of all deposits (6.7% up to €100,000 and 9.9% thereafter) was rejected by the Cypriot Parliament⁷. However the government subsequently approved a 47.5%⁸ levy on all deposits of more than €100,000.

¹ In 2011, Russia granted Cyprus a loan of €2.5 billion over five years.

² <https://www.imf.org/external/pubs/cat/longres.aspx?sk=43649.0>

³ http://www.consilium.europa.eu/en/press/press-releases/2016/03/07-eurogroup-statement-cyprus/?utm_source=dsms-auto&utm_medium=email&utm_campaign=Eurogroup+Statement+on+Cyprus

⁴ http://www.lemonde.fr/economie/article/2012/11/22/chypre-a-besoin-d-une-aide-de-17-milliards-d-euros_1794822_3234.html

⁵ Entered into force on 27 September 2012.

⁶ Much criticism was levelled at this measure as it conflicted with the [Directive on Deposit Guarantee Schemes](#).

⁷ <http://www.reuters.com/article/us-eurozone-cyprus-vote-idUSBRE9210ZB20130319>

⁸ http://www.francetvinfo.fr/monde/chypre/chypre-les-comptes-de-la-bank-of-cyprus-taxes-a-47-5-au-dela-de-100-000-euros_380122.html

Christopher Pissarides, a Cypriot citizen who was awarded the Nobel Prize for Economics in 2010, does not want to downplay the impact of this measure which was put forward as a protective mechanism for small savers: "From a social standpoint, this method was extremely brutal. The levy did not only affect millionaires but also many elderly people who had been saving for their retirement to make up for the shortcomings in the state system"⁹.

A strong desire not to follow in Greece's footsteps

Besides the focus on slimming down and stabilising the banking sector, the other two strands of the Memorandum of Understanding were fiscal consolidation and the implementation of structural reforms to boost competitiveness and growth. Measures set out in the agreement included:

- Increasing the statutory corporate income tax rate from 10% to 12.5% (together with Ireland, Cyprus still has the second-lowest rate in the EU¹⁰)
- The twice-a-year automatic wage indexation mechanism (COLA) was reformed. It was suspended during the years when the country was in recession.
- The plan for the privatisation of government-owned companies was subject to much discussion and was only approved by Parliament on 3 March 2014. Klaus Regling, Managing Director of the ESM, has pointed out that the Cyprus Telecommunications Authority (CYTA) has still not been privatised¹¹.

Out of the €10 billion available under the programme (€9 billion from the ESM and €1 billion from the IMF), Cyprus drew down €7.3 billion (ESM: 6.3 and IMF: 1). According to the government, this was due to the economic recovery, the contribution of private investors to recapitalising the banks and the country's earlier-than-expected return to the financial markets owing to the upgrading of its ranking¹².

The public sector has also been asked to weigh in (in 2010, it accounted for 17.3% of the workforce). In July 2015, the President Nicos Anastasiades announced the Public Administration Reform (PAR)¹³, in particular, in respect of hiring, promotion, appraisal and remuneration. The reform bills will be implemented starting on 1 January 2017 and will, in the President's words, meet "the demands of society and the public [that] are becoming greater for those institutions when it comes to meritocracy, good administration, fairness, transparency and accountability of the state to its citizens"¹⁴.

On the other hand, the agreement reached with the main civil servants' union (PASYDY) provides that the "special contribution" imposed on civil servants' salaries – which brings in some €70 million annually – will be abolished on 31 December 2016¹⁵. This measure was announced by the new Chairman of the Public Service Commission, Constantinos Petrides.

Groundwork for a second reunification in Europe

For the first time since Turkey annexed the northern part of the island in 1974, Nicos Anastasiades, President of the Republic of Cyprus and Mustafa Akinci, the new President of the Turkish Republic of Northern Cyprus (TRNC)¹⁶, issued a joint Christmas message on television on 25 December 2015¹⁷. Both men, who were born within a year of each other in Limassol, are strongly in favour of reunification. They referred to the significant progress made since talks resumed at their initiative in May 2015. Successes include the setting up of a special committee tasked with laying the groundwork for the future Federated Cypriot Turkish State to adopt EU legislation.

Twelve years after the failure of the Annan Plan¹⁸, and although many issues have still not been settled (including expropriations and military presence), there is increasing hope that the island will be reunified. When he visited Nicosia¹⁹, Frank-Walter Steinmeier, the German Minister for Foreign Affairs, spoke of an "historic opportunity" and offered Berlin's assistance. The two communities are working on arranging a referendum which could be held in the Autumn²⁰.

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⁹ <http://www.spiegel.de/wirtschaft/soziales/warum-zypern-kein-zweites-griechenland-wurde-a-1080339.html>

¹⁰ The "standard rate" ranges from 10% in Bulgaria to 35% in Malta. It is 33.33% in France.

¹¹ <http://www.esm.europa.eu/press/videos/cyprus-successfully-exits-esm-programme.htm>

¹² <http://cyprus-mail.com/2015/07/06/a-fairer-more-responsive-civil-service-on-its-way/>

¹³ <http://www.reform.gov.cy/en/public-administration-reform>

¹⁴ <http://cyprus-mail.com/2015/07/06/a-fairer-more-responsive-civil-service-on-its-way/>

¹⁵ <http://cyprus-mail.com/2015/08/26/cabinet-approves-civil-service-reform-bills/>

¹⁶ A self-declared state that is only recognised by Turkey.

¹⁷ <http://www.dw.com/de/hoffnung-auf-wiedervereinigung-zyperns-nach-tv-ansprache/a-18942245>

¹⁸ <http://www.robert-schuman.eu/fr/oe/0289-echec-du-referendum-sur-la-reunification-de-l-ile>

¹⁹ <http://www.dw.com/de/zyperer-sollen-historische-chance-nutzen/a-18856284>

²⁰ <http://www.lorientlejour.com/article/979962/reunification-de-chypre-un-referendum-a-lautomne-.html>