

Considerations and challenges concerning Cyprus

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“Most worryingly, hopes of the euro navigating the debt crisis successfully were hit badly by its leaders’ breathtaking amateurishness in the Cyprus case.

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” That’s how the FT concluded its [editorial comment](#) after a week of capricious challenges concerning Cyprus. After first announcing a bail-out for the island nation which included a 6.75% “tax” (i.e., haircut) on deposits up to € 100,000, Eurozone leaders backtracked after a week of economic turmoil in Cyprus, bilateral negotiations with Russia and polite but vocal protests from Cypriots.

The executive deficit that Europe labours from in the [analysis of Nicolas Véron of Bruegel](#), became acutely visible and was exacerbated by the [interview](#) given by novice Eurogroup chair Jeroen Dijsselbloem who was understood, wrongly, it appeared, to call the Cyprus bail-out a template for future cases, only to backtrack later with a terse, two-line [statement](#).

As some observers noted, the bail-in provisions for a joint EU-wide resolution regime for banks have been brought forward from their planned introduction in 2018 to 2013. Here are seven considerations after a week of banner headlines on Cyprus.

1. A geo-political remark to begin with. It would have been wise had Cyprus been admitted to the EU in undivided state. The best chance of finding a lasting solution between the Greek and Turkish parts of the island might have been if reunification had been made a precondition for accession.

Not insisting on unification before entrance into the Union was a missed opportunity. Cyprus is part of the European family now. Our family concerns should extend to the Turkish population in the Northern part of the island, whose language appears on Cypriot euro coins (that contain language in Greek and Turkish).

2. A similar missed chance is the resolution of Cypriot banks well before a week of feverish emergency. The losses incurred in respect of Greek assets due to the ‘Private Sector Involvement’ agreed in the second Greek rescue package hit Cyprus hard. A long time has elapsed without a resolution of Cypriot banks who were badly affected.

3. A third missed opportunity concerns the bloated Cypriot financial sector, many times the size of the State's GDP. In line with early analysis of the crisis by [Adair Turner](#), chairman of the UK's Financial Services Authority, that the disparity between financial sector size and the real economy was one of the factors behind the financial crisis, a sizing down of the financial sector should have been addressed.

One might expect the European Systemic Risk Board (ESRB) to have warned for Cyprus' over-sized financial sector. Ireland's economic success model also suffered from an oversized financial sector, and the sector's size is far greater than the real economy in the UK, and the Netherlands, too. When will the ESRB, established to monitor systemic risk in the EU, address warnings on this issue?

4. A fourth missed opportunity was not addressing the serious concerns about money laundering and tax avoidance in the Cypriot banking system. Banking union needs to ensure that the banking system is as clean as possible across the euro area.

5. A fifth consideration concerns capital controls. They do not belong in a single currency area, as [Guntram Wolff of Bruegel](#) rightly argued in the FT of 25 March 2013. Temporary capital controls are perhaps unavoidable, in view of the situation, but they undermine confidence in the single currency and are probably legally questionable.

6. A sixth consideration is on the urgency of executive and legislative action. We need to accelerate the move towards banking union, and to bring forward an EU-wide recovery and resolution regime for banks. The unease caused by the original plan to hit small savers means that Europe-wide deposit insurance up to € 100,000 needs to be realized sooner rather than later.

7. Finally, even though a lot is still to be developed and improved (see points 1-6), the package finally adopted may constitute another step in addressing the crisis of EMU. Taking a longer-term perspective, as fellow EU law professor Ton Eijsbouts urges us to do, the Cypriot rescue may be seen as another step in the hesitant but sure approach towards remedying defects of the currency union and towards stronger and more effective governance in Europe.

Source: <http://fd.nl/economie-politiek/columns/rene-smits/798610-1303/considerations-and-challenges-concerning-cyprus>