Cyprus prepares for euro bailout

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The Mediterranean island of Cyprus, which takes over the presidency of the European Union on July 1 has been swept up in the vortex of the European debt crisis. It is expected that the island republic will be forced to apply for a loan from the euro bailout funds. This would mean that following on the heels of Greece, Ireland, Portugal, and Spain, Cyprus would be the fifth of the 17 euro area countries to take money from the bailout fund.

The rating agencies Moody's and Standard & Poor's downgraded the country to junk status last week. They justify the downgrading by the close links between Cypriot banks and Greek finance houses. A large proportion of all claims by Cypriot banks are on Greek debtors. By the end of the month, the country's second largest bank, the Laiki Bank, needs an injection of 1.8 billion euros to meet the requirements of European Banking Supervisors. This sum represents about 10 percent of the country's gross domestic product.

According to the *Financial Times*, Cypriot banks have at least 22 billion euros in outstanding private and corporate loans in Greece. Three billion euros in bank assets have already been written off in a debt cutting exercise. Any withdrawal of Greece from the euro would mean the complete collapse of banks in Cyprus.

Cyprus' economy is closely linked to that of Greece. The country conducts a fifth of its trade with Greece, and a quarter of foreign investments come from its neighbor. It is now in its third consecutive month of recession, and this year, economic output is expected to shrink by 1.6 percent.

The Cypriot Finance Minister Vasso Shiarly has described the situation as "extremely urgent". The application to the euro rescue fund will not be limited to the banks. "If one turns to the support mechanism, then one takes into account all the facts, including the requirements which could arise in the future," the minister declared. "Accordingly, what is necessary is a full application, which covers not only current circumstances and the recapitalization of the banks, but also future needs."

Cyprus will also attempt to get money from other sources. Last year it received a bilateral loan of 2.5 billion euros from Russia, and there are rumors that it is negotiating with China about a cash infusion.

While the economy of Cyprus represents a small part of the euro zone—just 0.2 percent of the total—the island is situated in an important strategic position in the eastern Mediterranean. It lies less than 200 km from the Syrian coast and is home to an important British military base. At the same time, significant Turkish military units are stationed in the north of the divided island.

The Russian (and possible Chinese) financial assistance for Cyprus is undoubtedly bound up with their own strategic interests in the region. The UK and in particular, Turkey, have been in the forefront of those calling for a military intervention against Syria, with Russia and China adamantly opposed to such a step.

Financial aid to Cyprus is a controversial issue in the European institutions. A European Commission spokesman told the media on Monday that the commission was confident that Cyprus could deal with its problems alone. Compared to the financial demands of other European countries such as Greece and Spain the sums required to stabilize the banking system in Cyprus would be comparatively small. But EU officials fear that a loan to the country could send the wrong message to other ailing states.

The EU is also worried that the government of President Dimitris Christofias will not pursue austerity measures with the ruthlessness demanded by Brussels. Christofias, who has governed for four years, is a member of the Progressive Party of Working People (AKEL), which emerged from the island's Stalinist

Communist Party.

The AKEL unconditionally supports the austerity measures demanded by the European finance elite. Last year, his government voted along with all other parties in parliament for the recapitalization of the Laiki Bank using government funds. “A bankruptcy would have disastrous consequences for the banking system and also for the entire economy,” was the justification given by an AKEL spokesman for the measure.

Christofias has sought to dampen down social opposition with occasional rhetorical attacks on EU austerity measures. “When the first austerity measures were introduced in Greece,” he said recently, “the country’s debt amounted to 115 percent of gross domestic product. After two years of austerity, the debt rose to 165 percent, that’s saying something.”

The opposition right-wing parties and the Social Democrats are calling for European funding and a radical austerity course. Assistance from the European bailout fund would be the best solution, declared the conservative MP Christos Stylianidis: “The government should seek out an EFSF loan to ensure that the reputation of Cyprus as a finance center is not harmed. We must send a clear signal that we are ready to subject ourselves to strict financial discipline.”

President Christofias had already reshuffled his cabinet following rumors of an application for aid to Brussels. The spark for the government crisis was a devastating accident in the port city of Limassol. Explosions took place at ammunition depots killing 13 people and destroying much of the nation’s energy infrastructure. The necessary repairs will cost two billion euros, about ten percent of annual economic output.

The AKEL’s concerns about political turmoil and social unrest are not unfounded. Unemployment and poverty have risen continually since the outbreak of the economic crisis. During 2008, the official unemployment rate was 3.6 percent; by 2010 it had risen to 6.5 percent. Youth unemployment is nearly 20 percent. The situation is even more dramatic in the breakaway northern part of Cyprus where unemployment is estimated to be more than twice as high as in the south.

The EU austerity package adopted by the government last year froze wages in the public sector and cut other social benefits for employees. In December, thousands of public employees went on strike against the cuts.

The AKEL is the largest and most influential party in Cyprus, with a long tradition of suppressing popular opposition and implementing reactionary policies in the interest of Western powers.

Founded in 1941 as a successor to the Stalinist Communist Party, it made a pact with various right-wing forces and called for the so-called Enosis, the annexation of Cyprus to Greece, on the basis of nationalism. After independence from the Britain in 1960, the AKEL had continuous representation in parliament and supported various bourgeois forces.

In the mid-1990s it campaigned for the island’s admission into the EU and supported the policies of right-wing governments until eventual accession in 2004. In the elections of 2008, Christofias prevailed against his conservative challenger and immediately after taking power assured Brussels that his government would do everything possible to shift the burden of the economic crisis onto the backs of the population.