Cyprus banks close as bailout terms spark Europe-wide crisis

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The terms attached to the European Union (EU) finance ministers' bailout for Cypriot banks triggered heavy losses on financial markets that were lessened only on the basis of an expected climb-down.

A vote in Cyprus's parliament was first postponed from Sunday until Monday, and then until today, as it remained uncertain if President Nikos Anastasiades could win majority backing for the plan. In a statement on national television Saturday, he declared that Nicosia had no other alternative but to accept the terms of the programme if the country was to avert a full financial collapse. He compared the current crisis to the Turkish invasion of the island in 1974, which led to partition.

The current version of the plan will see around 10 billion euros ($13 billion) made available to the island's banks, and close to a further €6 billion raised through a tax on banking deposits. Accounts with a balance of less than €100,000 were to be taxed at 6.75 per cent, while those with more than that amount faced a 9.9 per cent charge.

With banks closed, depositors emptied ATMs over the weekend. The terms of the bailout met near universal hostility from widely varying layers of the population. Banks due to open today after a bank holiday are to remain closed until Thursday to prevent further panic withdrawals.

Accounts differ as to who proposed what in discussions leading up to the EU decision to levy a tax on small investors. The Cypriot government blamed Berlin, which countered that it was Cyprus that decided to levy a tax on small investors after rejecting suggestions of a bigger tax—up to 40 percent—on those with over €100,000 in Cypriot banks.

In either event, the terms agreed represented a breach of existing guarantees that small investors are safeguarded from the consequences of the banks' bad practices.

Berlin's portrayal of the measure as a policy targeting Russian oligarchs using Cyprus as a tax shelter did nothing to lessen public outrage.

Long-running negotiations over a bailout for banks controlling assets worth more than eight times GDP have brought divisions between the European powers to the fore. The key measures in the bailout were dictated by the German government, which was unwilling to play the main role in funding a full-scale bailout. Finance Minister Wolfgang Schäuble pushed for the bank deposit tax, as well as the demand that Cyprus increase its corporation tax from 10 to 12.5 percent.

These measures, which will contribute approximately 40 percent of the overall cost, are aimed at strengthening Berlin's position against Russian and—to a lesser extent—British investors. Russian investors control a total of €19 billion of bank deposits in Cyprus, equating to 7 percent of all Russian corporate deposits. The island has become the second-largest source of foreign direct investment into Russia, as many companies have set up bases there to take advantage of low corporate tax rates.

Britain, the former colonial power, views Cyprus as a strategic location and maintains a military presence on the island with around 3,000 troops. Approximately €2 billion of bank deposits are controlled by Britons, around 30,000 of whom live there.

Behind calls for a struggle against "money-laundering" and funds from the "black market", which were embraced by the opposition Social Democrats as well as the Merkel government, one aim of the bailout was to undermine the position of Russian and British investors. President Vladimir Putin denounced the measure as "unjust, unprofessional and dangerous."

However, the levy also ensures that working people in Cyprus are made to bear the costs for the bailout of the country's failed financial institutions. In reality, the oligarchs and the wealthy have far greater ability to withdraw their funds than Cypriots, Greeks and other smaller investors—unless Cyprus were to take the extraordinary decision to impose capital controls.

In January, €43 billion of the €68 billion in Cypriot bank deposits was held by domestic residents, with a further five billion held by Greeks.

Some within the bourgeoisie supported the notion of making Russia pay, but most considered the taxing of small investors a political disaster, fearing that both measures raised grave dangers.

The decision to seize investors' money overnight could provoke a bank run in other European countries—with savers in Spain, Portugal or Italy fearing the possibility that money may also be removed from their accounts in the future. Cyprus is a warning of what might happen. In the first two weeks of February alone, $1 billion in deposits were removed from banks in Cyprus, as speculation grew that the tax would be imposed.

Greek financial commentator Yiannis Mouzakis wrote, "Deposits flight combined with the sale of the Greek operations will probably leave the Cypriot banking system half the size it was on Friday night, even left with one systemic bank after restructuring."

If this were to be repeated in other struggling countries the potential for devastating contagion is incalculable.

Germany's media was filled with dire warnings.

D ie Welt asked, "Who can say that at some point the Cyprus model will not be used by banks in Italy or Spain? And that bank customers could lose far more than 10 percent?"

Süddeutsche Zeitung wrote, "Banks closed, money gone, confidence destroyed. The last taboo of the euro crisis has been broken, and it's now reaching directly into savings accounts… The crisis surrounding the euro has unexpectedly reached a new level of escalation."

Handelsblatt declared, "Cyprus sets a precedent. What happens there can also happen elsewhere. In Spain and Ireland, bank bailouts have allowed the national debt to explode to an unsustainable level. There, the euro zone could see tapping into bank accounts as the next step. In principle, no European depositor can remain assured that their bank balance will remain untouched—even in Germany."

Jean-Claude Juncker, the prime minister of Luxembourg and head of the 17-nation euro group, told AFP: "I have grave concerns that this will lead to a loss of confidence, not just from the banks but also from the people."

With so much at stake, some rejigging of the terms of the bailout may well be made before it is re-presented today. But, as with all such "bailouts", only the bankers and the super-rich benefit, while the working class is made to suffer.

The Cyprus bailout, like those for Greece, Spain, Portugal and Ireland, is conditional on the launching of a vast austerity programme, including privatisations, which will lead to the elimination of jobs in the public sector and the destruction of social services. A public sector strike took place a day prior to the EU finance ministers' announcement, involving up to 16,000 state employees. It was called against wage freezes and budget cutting.

Paul Krugman of the *New York Times* commented that the levy on investors "is just the beginning! Even with the effective default on deposits, Cyprus will need a huge loan from the troika, and the condition for this loan will be harsh austerity. This looks like the beginning of endless, inconceivable pain."