Europe in crisis as Cyprus faces national bankruptcy

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The vote by Cyprus's parliament Tuesday evening to reject the terms of the European Union (EU) bailout agreed last Saturday has deepened a crisis which threatens to spread across Europe, posing the risk of national bankruptcy.

Thirty-six parliamentarians voted against the deal, while 19 abstained and none voted in favour. The initial bailout plan would have charged investors with deposits in Cypriot bank accounts a tax of 9.9 percent for those with account balances of more than €100,000, and 6.75 per cent for those with balances between €25,000 and 100,000. This would have raised €5.8 billion to support the proposed €10-billion-euro EU bailout for Cyprus' banks.

With thousands gathered outside parliament to protest, a last-minute adjustment to exempt those with less than €20,000 from the levy had no impact.

President Nikos Anastasiades called an emergency meeting of all political parties to work on a "Plan B." But a proposed alternative it drew up yesterday was rejected by the troika—the European Commission, the European Central Bank and the International Monetary Fund.

The total collapse of Cyprus's financial system is being avoided only by the continued closure of the banks, which will now be kept shut until next Tuesday. The stock market also announced on Tuesday it would close for two days, amid fears that investors would withdraw large quantities of capital.

Negotiations with the EU are on-going, but EU officials insist that Cyprus raise €5.8 billion as a contribution to the bailout.

German Finance Minister Wolfgang Schäuble remarked after the vote, "The ECB has made it clear that without a reform programme, the aid can't continue. Someone has to explain this to the Cypriots and I think there is a danger that they won't be able to open the banks again at all."

"Two big Cypriot banks are insolvent if there are no emergency funds from the European Central Bank," he added.

The island's two main banks, Laiki and Bank of Cyprus, are being kept afloat only by emergency credit made available by the ECB. ECB officials have warned that the failure to ratify the bailout agreement would result in the ending of this support.

The EU's hard line indicates thinking within European ruling circles that Cyprus's bloated banking system cannot be saved and that, in some quarters including German Chancellor Merkel's coalition partners in the Free Democrats (FDP), it should be allowed to fail.

Bernd Riegert titled a comment published by *Deutsche Welle* "Time for Cyprus to leave the Euro zone."

Bailing out Cyprus's banks is no small feat. Martin Wolf pointed out in the *Financial Times* that Cyprus gross government debt reached 87 percent of gross domestic product last year and would reach 106 per cent of GDP by 2017, without the bailout. Its sovereign credit rating is also far below investment grade at CCC+ due to having banking sector assets over seven times GDP.

"Without taxing depositors, the proposed rescue package would have had to be €17.2bn, instead of €10bn, or close to 70 percent of GDP," he wrote. "This would have brought sovereign debt to some 160 percent of GDP: an unsustainable burden. Indeed even the actual bailout package looks unsustainable, since it would appear to bring gross debt to 130 percent of GDP."

Allowing a bank collapse is a high-risk strategy, however. The chaotic developments are exacerbating the instability of the euro zone. Amid a deepening recession across the continent, on-going negotiations over a working government in Italy, and the unresolved problems of the massive debts of European banks, the response in ruling circles has been characterised by mounting panic and uncertainty as to the potential impact of events.

Stocks fell in other so-called peripheral European economies. Values of Italian and Spanish banks fell by up to 5 percent on Tuesday, and the stock exchange in Athens was down by over 3 percent. The euro reached its lowest level in four months, falling below 1.29 against the US dollar, before rising slightly after the ECB's assurance that it would support Cypriot banks for the time being.

The BBC's economics correspondent Stephanie Flanders summed up the mood, writing Tuesday, "We don't know yet whether the damage done in the past few days will turn out to be fixable. But we can say everyone seriously miscalculated."

Klaus Regling, head of the EU's permanent bailout fund, the ESM, told the German daily *Bild* that an uncontrolled default in Cyprus could place the euro as a whole at risk.

James Mackintosh, in the *Financial Times* asked whether a refusal to bailout Cyprus would "prompt a renewed euro crisis" and replied, "For sure."

As well as the fear of contagion emanating from this small island, the European powers will be worried about the possibility that abandoning Cyprus will drive it decisively into the orbit of Russia.

The agreement to levy investors in Cyprus's banks angered Moscow, because upwards of $45 billion of Russian money is held on the island. Wholly eliminating the levy on deposits below €100,000 would mean raising the higher levy to 15 percent—hitting the oligarchs, mafia elements and other Russian nationals even harder. This would prompt massive withdrawals and probably collapse the banks.

Cyprus therefore increasingly relies on Russian patronage, amid escalating international tensions, at the risk of antagonizing the European powers and ultimately the United States.

Its finance minister,Michalis Sarris, arrived in Moscow Tuesday to renegotiate the terms of a 2.5 billion euro loan made by Russia in 2011, with lower interest payments and an extended deadline to 2020. More significantly he has sought a further five billion euros on top—almost the entire shortfall on the EU bailout.

Worse still for the European powers, speculation is rife that Moscow is seeking the right to use the Cypriot port of Limassol as a naval base. Currently, Russia relies on a base at Tartus in Syria to access the Mediterranean. However, the current Syrian regime of President Bashar al-Assad is the target of a US-led war for regime change also directed against Russia and China.

There might also be a trade-off based on Russia's Gazprom accessing as-yet untapped offshore gas reserves, estimated by Noble Energy to be well in excess of 5 to 8 trillion cubic feet based upon an initial investigation in 2011. Cyprus's energy minister accompanies Sarris.

An unstated but no less pressing concern is the potential for the outbreak of mass opposition to the EU and its drive to bail out the financial elite at the expense of working people.

Proposals to reach a Plan B will do nothing to change the fundamental character of the bailout, which demands a massive attack on the living standards of the working class. Coming after a large anti-EU vote in the Italian elections, on-going strikes and protests in Portugal, Greece and Spain, and the toppling of the Bulgarian government last month, ruling circles are well aware that class relations in Europe are at the breaking point.