Understanding of the Financial Crisis in Cyprus, Its Effects and the Post Crisis Strategy

Master Thesis For the Degree of Politics & Economics of Contemporary Eastern and South-eastern Europe

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Declaration

I hereby declare that this very thesis is a work of my own and all the references used while gathering of relevant data have been properly indicated.

I am well aware that a false declaration may have serious consequences.

Date: ----------

(Signature)

Abstract

This paper focuses on Cypriot economy with a special emphasis on the effects and aftermath of the financial crisis that it has gone through. An overview of the island's economy and its key elements will help to get the thorough understanding of what had gone behind the screen. Cypriot banking system in general and the situation around the globe that helped shape the crisis will form part of the project. Situation around Europe, Admittance into EU and ultimately Euro played an equally important part in the financial crisis history of the country. Banking operations and especially the expansion program devised by the biggest banks will be criticised.

Early symptoms and Cypriot entry into the financial difficulty will be highlighted along with all the other factors that contributed to the ultimate demise of the huge banking empire. The crisis period will form a part of the paper with all the relevant factors be considered. European Union's part and other unfortunate events will be analysed throughout in the later area of this paper. Greek bonds and Cyprus' reliance on Greece will be evaluated extensively as this area is at the core of the whole financial crunch and will help understand the story of the troubled nation.

Much criticized bailout package will be discussed and the Economic Adjustment program initiated by Cypriot Government in the close collaboration with the European authorities will be highlighted in detail. Cypriot connection and similarities with other European countries which went through the similar financial phase after entry into the Euro will also be written about. Ultimately the current situation and the recovery route will be discussed along with the current performance of the government and other sectors.

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List of Abbrevations

ECB: European Central Bank

EU: European Union

CBC: Central Bank of Cyprus

ELA: Emergency Liquidity Assistance

1. INTRODUCTION:

The island country of Cyprus has always been a debate subject and a point of controversy. Now a Eurozone country, area wise it only accounts for 0.2% of the European Union but politically and culturally has a much larger footprint across the continent.

The location of the island is of extreme importance as it marks the border line of the European Union to the east with Northern Africa and the Middle East. Countries to its east faced a political and social turmoil for years now with Israel/Palestinian conflict, Civil War in Syria and Lebanese Instability just to name a few.

History the island is one of the oldest settlements recorded by the mankind and is home to the first man made water wells. Political turmoil has always been associated with it and it was 1974 when Greek and Turkish Cypriots collided and resultantly the island got divided in two halves.

Economy of Cyprus is not extremely diversified but is adaptable and is reliant on Tax Planning, Trusts, Foreign Exchange business and Legal Setups[1]. Cyprus also has double taxation treaties with a number of other countries making it an ideal location to invest.

Why Cyprus is so famous nowadays? A relatively easy question to answer, because of their financial crisis they faced very recently. Before going into much more detail it needs to be highlighted here that what is the island country most famous for.

It is the banking system of the Mediterranean nation. It used to be one of the few places on the planet with such lenient rules of lending abroad rest alone the locals. Taxation is also pretty favourable to those who can dump a lot of currency in their bank accounts.The banking sector that Cypriots established over decades was once thought invincible and attracted a lot of foreign money into the country. This marked an encouraging sign for the industry and the sector grew at an unprecedented rate. At the point of collapse in the economy the banking sector was 8 times the GDP of the tiny nation, only Luxembourg in the European boasted the higher figure of having a banking system over 20 times the GDP (Stein, 2013).

Such huge burden on a small population took its toll and what happened later on is in the newspapers.

2. CYPRIOT ECONOMY:

Economy is dominated by the service sector with tourism, financial services and Real estate being the biggest contributors. It accounts for over 78% of the total GDP (Cyprus Economy, 2010).Since 2000 the economy was on a real high and represented the growth over and above the average rate in the whole EU. However it is also proved that the above economic sectors are heavily reliant on the political stability and the general conditions across the Western Europe.

[1] The legal system in Cyprus follows the English Common Law, making it more compatible with the international markets.

Industrial sector is accountable for around 19% of the GDP and consists of Ships Repair and Maintenance industry, Cement and Gypsum Production and Beverage Processing. Agriculture sectors add up around 3% of the GDP.

3. AN OVERVIEW OF BANKING SYSTEM IN CYPRUS:

Cyprus has (or once had) one of the best performing banks in Europe. The biggest banks of the island country are Bank of Cyprus, Cyprus Popular Bank and a number of Co-operative societies and Credit Institutions. Between these three is the 67% of the market share in terms of deposits. A few major institutions are:

1. **Bank of Cyprus:**

The oldest and the biggest bank and in operation since 1899. Banking network of Bank of Cyprus is spread across Russia (194 Branches), Greece (187 Branches), Ukraine (42 Branches), Romania (10 Branches), United Kingdom and Channel Island.
Focus is at Retail Banking, Corporate Banking, Internal Banking and Asset Management. Assets of the Bank (as of 2012) are reports at €43bn and have the following market capitalisation in Cyprus:
Holds 41% of total Deposits and 36% of total Loans within Cyprus.
Holds 40% of the Foreign Currency deposits within Cyprus (Pochanis, 2012).

2. **Cyprus Popular Bank:**

The second largest institution in service since 1904 and is the very first company registered in Cyprus in 1924. Like its counterpart, Bank of Cyprus it also has diverse operations with Greece, Serbia, Malta, Estonia, Russia and Ukraine amongst the areas served. Majority of its shares, 18.69% are owned by Dubai Financial Limited Liability Company whereas Marfin Investment group comes next in terms of shareholding with 9.49% of its shares.
Assets (as of 2012) are reported at about €34bn and have the following market capitalisation.
Holds 16.85% of total deposits in Cyprus.
Holds 16.25% of total loans in Cyprus (Cyprus Popular Bank Prospectus, 2012).

3. **Cooperative Banks and Credit Societies:**

These are various institutions ranging from small to large and professional and are known to be operating at much more local level than other commercial banks. The biggest of these are the Co-operative Central Bank and Limassol Co-operative Savings Society. The Co-operative banks were a particular point of interest during the credit crisis as they were largely unharmed by it. Assets of collective cooperative societies (as of 2013) are reported at about €12.5bn whereas the capitalisation stands at:
Holding €7.4bn deposits and €7.5bn of loans (Independent Due Diligence of Cyprus Banking System, 2013).

4. GLOBAL SITUATION & TRIGGER FOR CYPRUS:

First the discussion about the global chain of events that led to the Cypriot recession seems mandatory. Important set of events are:

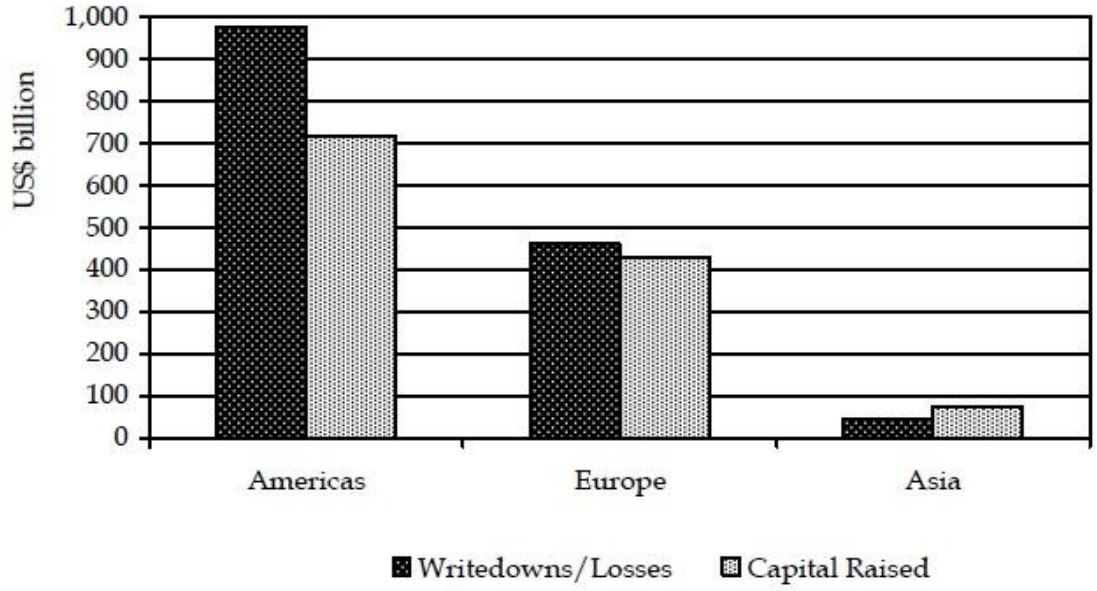
1. **US HOUSING BUBBLE:**

The foremost cause of all the financial mess is still a debatable subject but one of the main reasons of global crisis seems to be the Housing boom in the United States. Early to mid-2000s is a period attributed to uncontrollable growth in almost every sector. Housing and mortgage area was not different either. Low interest rates, Weak financial and accounting systems, and existence of different regulatory frameworks for the key institutions like Investment Banks, Commercial Banks and Government finance house fuelled the situation.

Risk was not calculated properly and this led to a number of huge mistakes on the part of world's leading financial institutions.

By the advent of 2006, competition rose to an unbearable limit and the market slowly started to decline. Here the situation was manageable but the big institutions given the amount to Gearing they were exposed to start to panic sell their acquisitions e.g. properties, derivatives and other financial assets to stay liquid. The effect can be seen in the figure below

Reported losses and capital raised by global financial institutions (June 2009)



The undervaluing and excessive selling made the situation look worse and general speculation played a key role in bringing the crisis to its very doorsteps. In Cyprus overseas investment in the property sector also led to its demise where it was thought that land in Cyprus is safe and is an asset that never depreciates.

2. **Collapse of Lehman Brothers:**

One of the oldest investment banks in the United States, Lehman Brothers filed for bankruptcy in 2007. It was a major blow for all the institutions and stakeholders as almost all the banks started reviewing their credit policies and obtaining finance again became difficult. Banks now were looking closely at the financial profile of each country and determined their

assets, sources of revenue and liabilities (Leontiades, 2013). Interest rates rose again and specifically for the countries having greater credit exposure and limited repayment sources such as South-eastern Mediterranean countries like Greece which marked the entry of crisis in the Mediterranean region.

3. **Euro and Lending:**

From the global part moving closer towards Cyprus it important to indicate the Euro effect and its contributions. Greece and Cyprus have always maintained strong ties and Cyprus has been heavily reliant on Greek Economy. Before euro the Greek Drachma was subject to serious deterioration and inflation was 5% -6 % on average (Historic Inflation Greece, n.d.). Given this situation it was difficult for Greece to obtain high credits and to justify any substantial financial expansion. Greek government was to pay high interest rates to secure any borrowings. But this changed with the Euro as excessive and easy credit throughout Euro was available for Greece and Cyprus was the ideal location to utilize this facility as it was the most liquid neighbouring country.

4. **Euro & Interest Rates:**

The interest rates across Cypriot banks were always a point of debate among foreign investors as they tend to be unusually high than their European counterparts but the easy availability of credit compensated the high interest charges. Euribor is the interest rate on which funds are granted to the banks themselves and further the bank utilizes these funds to further spread it to the end consumers and charges the rate set by ECB. Greater the difference between the two high the profitability be for the banks.

Euro changeover meant the Cypriot pound was fixed against Euro and since Euro was now the currency, the interest rates were had to be exact equal to the one issued by ECB i.e. substantially lower than existing Cypriot banks. This put some serious and sudden strain on the returns on the lending.

5. SYMPTOMS AND EARLY CRISIS PERIOD:

1. **A Tax Haven**

Cyprus is a country not much blessed with natural resources and huge manufacturing capabilities but its critical geopolitical location made it ideal for something else. It chose to be a financial sector with friendly investor environment. On average it uses to offer about 6-7% interest on deposits coupled with a low corporation tax rate of only 10%[2]. This attracted huge interest from foreigners especially Russian who were eager to deposit their fortunes elsewhere because of the unpredictable Russian banking System. At the height about 37% deposits held in Cypriot Banks were of foreign origins (The Cypriot Financial Crisis Explained, 2013).

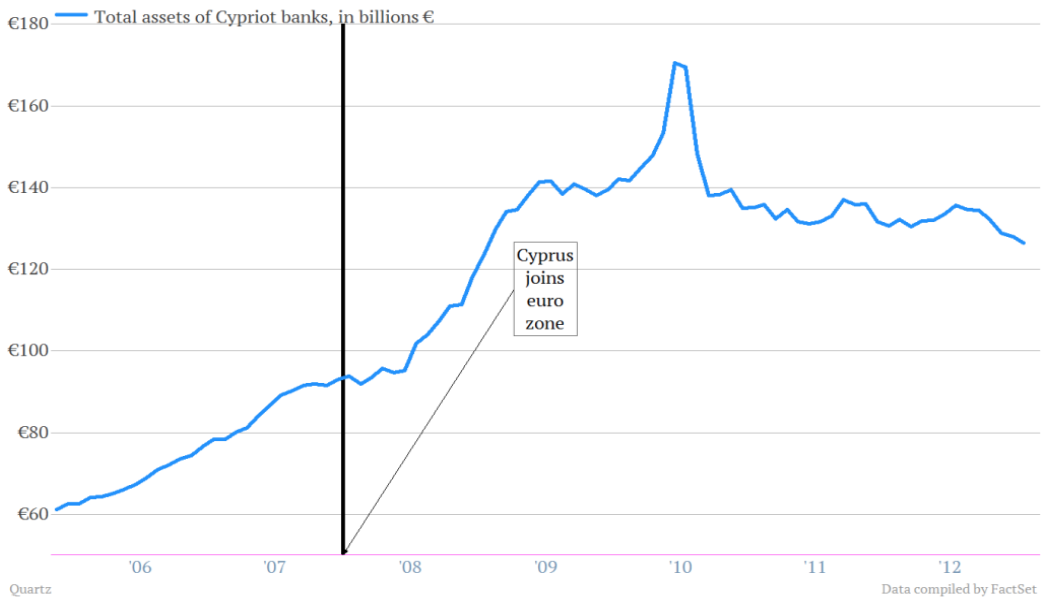
Another key factor was the Retiring people from Great Britain. Having a double taxation treaty with the UK, Cyprus enabled its resident to be free from any income being taxed again in the UK. This was particularly impressive as Cyprus had no Inheritance and wealth Tax plus there would be no withholding Tax on remittances back to Britain. High Income

[2] Even less than the 12% rate in Republic of Ireland.

Pensioners sought after this option rigorously as they were to exchange the UK taxation of around 40% to a Cypriot rate of only 5%. The individuals were allowed to pay only 5% tax on the excess amount of their Personal allowance or wealthy folks were allowed an extra tax free band and tiered taxation of up to 30% was levied upon them (Cowie, 2013).

2. **Size of the Banking Sector:**

As a result of being a lenient tax regime, Cyprus was becoming a banking giant and in the 2000s it really proved its position, but not in a good sense.



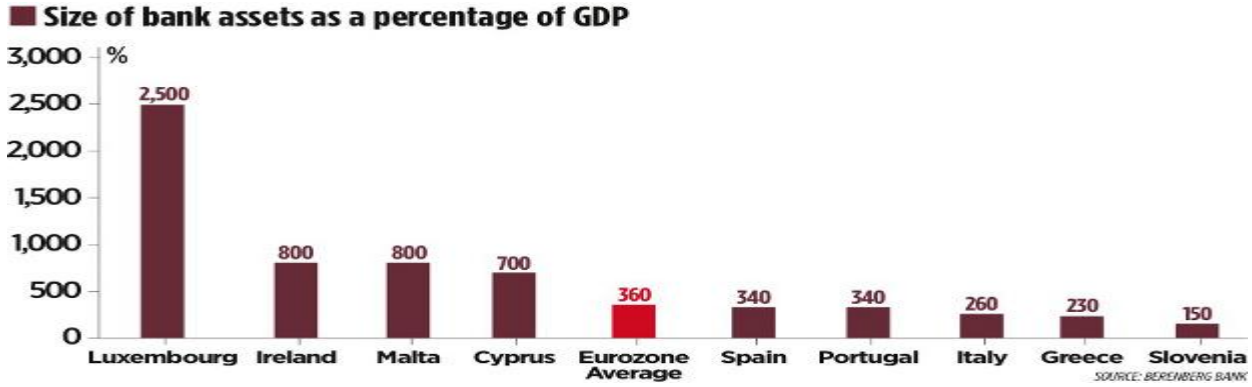
(Phillips, 2013)

Joining Euro was a milestone, and opened new trade and business routes for the country. Within the European Union all the deposits that were considered foreign before were now held as local deposits which helped increase the banking sector's size. Also Joining the Union gave other foreign nations the green Light to go ahead and invest in the Country affiliated directly with Europe. Above figure shows that since opting the Euro the assets of the banks reported more than a double figure with over 170 billion Euros in a couple of years.

Government and other regulators could have intervened but they didn't as they thought if they blocked any moves of the banks they were potentially hindering the country's growth.

Such enlargement came with its negative side as country was not able to handle such an enormous banking system which was much larger than itself. The size is not an ultimate factor in a collapse of a banking system however it is detrimental of the cost of the eventual bailout that might be needed as result of such crash. As a result they are facing right now and will have to bring down the size of their banking sector to a much acceptable level set by the EU of about 3.5 times the GDP (Strupczewski, 2013).

At its height Cypriot banking was 800% of its GDP standing third behind Ireland and Luxembourg depicted by the following figure.



(Chandarana, 2013)

3. Expansions and Acquisitions:

A. Acquisitions by the Bank of Cyprus

Expansion by the Cypriot Banks started way back in 1991 when Bank of Cyprus decided to setup services in Greece but in the late 2008 it took a potentially devastating step of acquiring a Russian Bank, Uniastrum. Russian Banks have not been credited with working in best financial environments around the globe and the acquisition did raise a few eyebrows.

At the time of finalising the deal it was considered a way forward in the bank's strategy and September of 2008 saw the bank of Cyprus buying 80% of the stake in Uniastrum for about $576million (Bank of Cyprus to buy Uniastrum, 2008).

It was the footprint of the bank along with its reasonable price that forced Bank of Cyprus to invest here. Return on the Investment was measured at more than 10% in just 2 years as Uniastrum had a network of 220 branches (Bank of Cyprus Completes acquisition, n.d.).

At start things were looking good as the Russian bank boasted a very balanced figure of both its Loans and deposits standing at €1.1billion each. But looking deeply revealed some serious wrong doings on part their part which made the investment questionable. Uniastrum made a number of undeclared cash payments to some of its employees, known for tax evasion and the two largest shareholders remained joint chairmen of the bank were some of the highlights that later prompted the deep investigation into the investment activities of Bank of Cyprus (Uniastrum was a dodgy buy, 2013).

B. Acquisitions by Marfin Laiki Bank:

Being the second biggest bank on the Island, Marfin Laiki or Marfin popular Bank (Now known as Cyprus Popular Bank) made a number of acquisitions in the mid and late 2000s.

Starting in 2001 they established 5 branches in Australia. 2005 saw them coming towards Britain and establishing banking in Guernsey. The same year they purchased 59% stake in the Bank Centrobank of Serbia (Laiki bank acquires majority stake, 2005).Later on they entered the Greek economy with full force by acquiring 95% of the controlling stake in the newly formed Marfin Egnatia Bank. They further acquired a 43% stake in Lombard bank of Malta for €48 million (Marfin Popular bank buys 43%, 2007). Further they also extend their activities in Ukraine and Estonia.

All these buying represented a serious threat for the going concern of the Marfin Laiki which was over-expanding during a global recession period.

4. **Investment Criterion:**

Downfall of Cyprus is much attributed to its Investment and Lending decisions rather than the external factors. With such huge influx of foreign money it was tempting to invest it somewhere in order to get a quick and handsome return. But the choice of Cypriots bankers can't be regarded as prudent as they went for the Greek Bonds (which will be explained later in detail) which were highly volatile at that point but their imaginary great return lured Cypriots into a crisis.

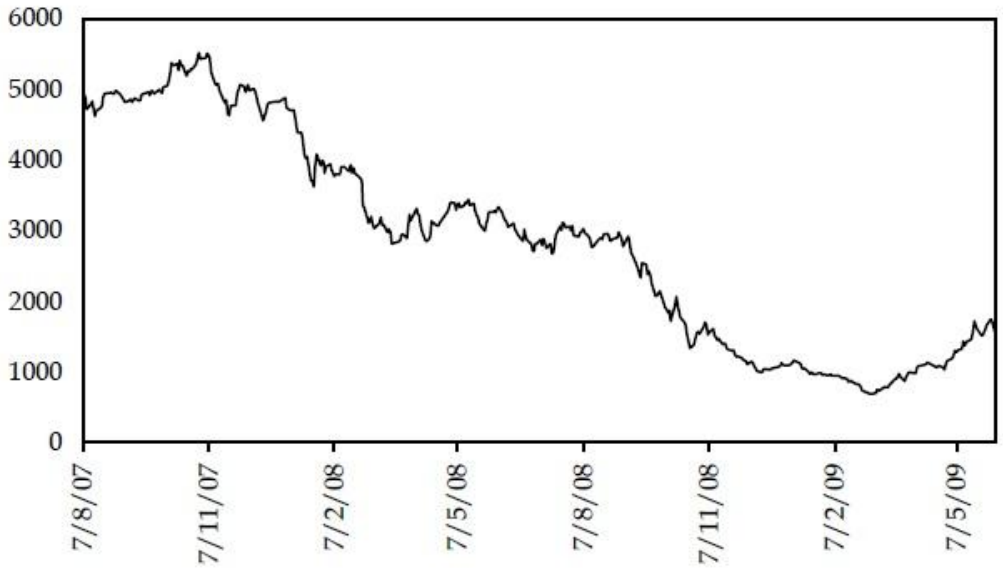
6. CRISIS PERIOD & BANKING (2006-2008):

The Period of 2006–08 and the happenings occurred in this era are of a particular importance which ultimately shaped the crisis. All the important events of 2006-08 are listed below.

1. Stock Index:

It started showing its effects in 2006 but finally it all kicked off in October 2007 when a steep drop in stock exchange was seen which was closely following the trend of the Greek index. The change was identical to the Greek economy because of having a dual listing of a number of large institutions in Cyprus on the Athens Stock Exchange. This drop was fuelled by the large institutional investors selling off their interest to mitigate the risk of a bad happening. This caused a Bear market to dominate for almost two years.

Evolution in the CSE index (August 2007-June 2009)



As explained above Accession in Euro in 2004 increased the Foreign Direct Investment (FDI) inflows and when Euro was adopted in 2008, it met with a prolonged credit boom. During these years low interest rates and availability of easy credit created a credit boom and property prices rocketed sky high leaving the private sector in huge debt. Lending to Residents in Cyprus escalated by 20% per year during 2007-08. Some other factor like increase in the wages is also considered vital which couldn't be justified with the labour productivity. Since labour was not productive enough but it was charging high, it led to huge downfall of cost and price competitiveness consequently huge trade and current account deficits started surfacing (Kröger 2012).

2. **Euro Deposits:**

Another factor to cause a huge upset in the economy was the transition in deposits. Before Euro the foreign currency deposits were subject to a strict control and were regarded as highly volatile. Because of their unstable nature the liquidity requirement was much higher i.e. high proportion of deposits must be kept in the form of liquid assets. This control imposed a limit of at least 70% assets held in liquid state. But since Euro was now the currency a big chunk of foreign deposits were now treated at a much lower liquidity requirement of just 20%, depriving banks with necessary cash (Pierides, 2012).

Increase competition was also a key here as 2008 saw two new Greek banks opting a penetrating strategy into the Cypriot banking structure. With the advent of these banks, Cyprus was facing a huge competition with 5 Greek banks now (three already were operating here).

3. **Basel II:**

Another black mark on the bank dealings was the adoption of Capital Requirements Directive (CRD) or commonly known as Basel II. This legislation states the capital amount that the banks must have in relation to the risks that they are exposed to. As soon as the balance is disturbed, legislation kicks in and forces the bank to introduce risk controlling measures. But there was a drawback of this law for Cyprus as it considered the government bonds (of any foreign nation) to be exempt of such risk measures hence considering them as zero risk. Cyprus had substantial stakes in Greek Government Bonds and Central Bank of Cyprus either ignored or missed out on that fact (Orphanides, 2014).

4. **Cypriot Property Bubble:**

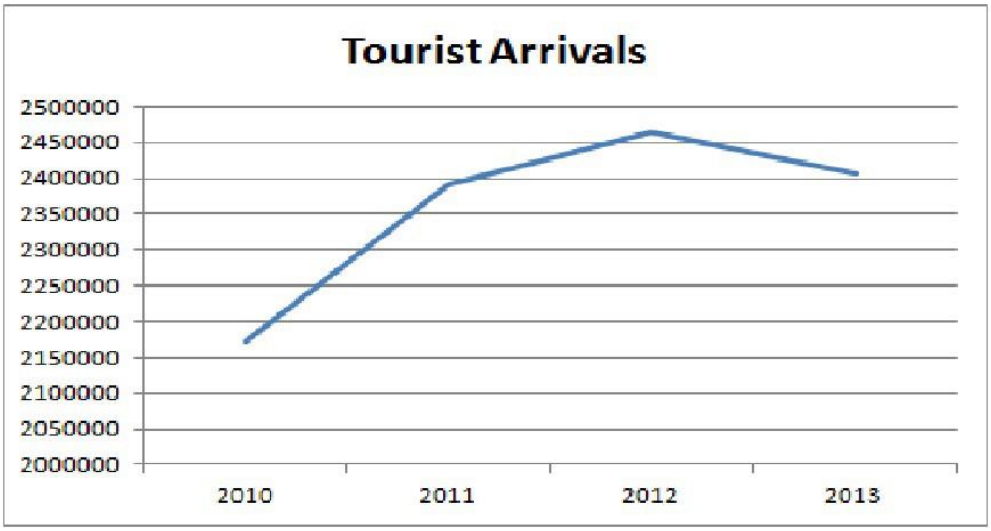
Banks were lending aggressively in the market between 2006-2008 and a major chunk of this credit was directed towards Property and Construction sector. A particular rise in the credit given was to non-residents as discussed above and the policy even continued until 2011 when out of the total loans of €30 billion (Regarding Real Estate), €6 billion were issued to non-residents (International Monetary Fund-Cyprus, 2011). Going back, the share of non-residents regarding housing loans in 2006 was a mere 3.2% but by 2009 it was an alarming 18.6%. The increase lending when questioned was responded by the fact that property prices were consistently rising and seemed a good prospect from lending point of view. However CBC introduced tougher measures to bring the banks back in line by restricting the ability of financial institutions to grant no more than 60% of financing in case the property bought was intended to be a second or a holiday home (The CBC target Prudential Measures, 2011). The decision was quite prudent but the timing was entirely wrong as financial crisis kicked in with full force just at that time. Real estate prices in holiday regions such as Ayia Napa, where buying is often of speculative nature, fell dramatically and banks faced a serious blow out of it.

5. **Construction & Tourism Situation:**

Cypriot Tourism was hit by recession and helped the country's downfall quite a bit. However it was in a much greater comfort zone as compared to the construction sector. Island is dependent on UK in more than just a few ways even after its independence and tourism is just

one of them. During the crunch period of 2006-2008 tourism did went significantly down mainly because of the global recession plus unfavourable movement of British pound against Euro. But comparing it with construction sector it was much less worrisome for the following reasons.

- According to CBC, tourism accounts for much less in terms of credit exposure which is just 6.5% as in 2007.
- Banks are not lending aggressively in tourism and hence there is no competition element involved.
- Tourism will recover in a short period of time once the situation gets slightly better and it did started its recovery which can be shown in the figure below



(Markides, n.d.)

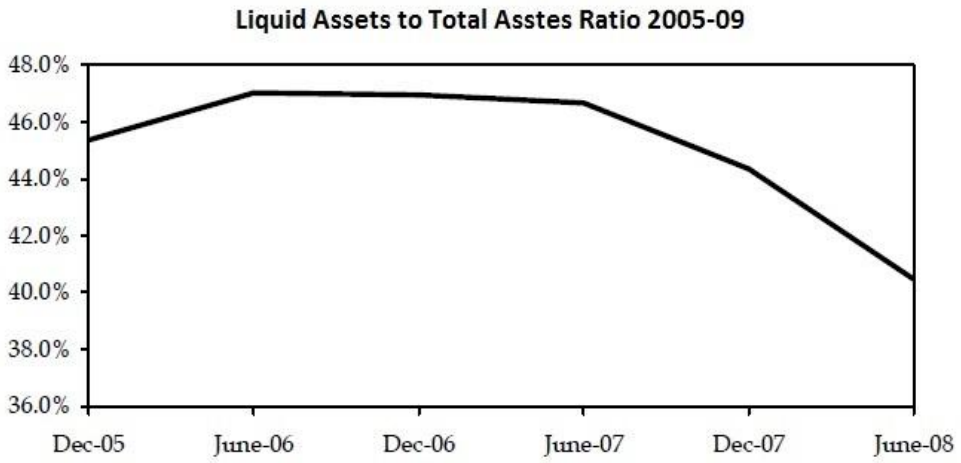
- Also regarding construction sector, a lot of exposure was old and hence the face value of loan was much less as compared to the collateral due to the increase in prices in Real Estate i.e. Properties became expensive and value of loans gone down comparatively, so banks were in loss altogether.

All the above 5 points contributed towards the demise of the banking sector in the following ways.

- Refinancing rates of ECB were reduced down dramatically out of nowhere and it was by far a steep decline globally. The movement can be observed below.

(A world of cheap Money, 2013)

- Since central bank of Cyprus had also linked the base rates with the ECB meant a large void of income for it and on the other hands the deposit interest rates kept rising.
- Increase in the deposit rates were partially because of the Greek situation where investors were liquidating their positions and Greece in order to retain the money was offering high interest rates. Because of the significant business dealings and a number of subsidiaries on the Greek mainland, the effect flown into the Cypriot territory.
- The cash or liquidity position of the banks was worsening. Loan to deposit ratio was rising and within a year it went up by 20% to 95% in 2008 as compared to 2007. The main reason wasn't the increased amount of loans but deteriorating deposits as much lenient liquidity requirement was in place for the foreign deposits.
- This also adversely affected the liquid assets held by the banks. Still the banks were at the comfortable level but it was an alarm for the forthcoming situation.



Political and Social Issues:

Other issues that contributed towards fuelling the crisis were detrimental and are as follows.

Vatopedi Monastery:

The religious ranks residing in a remote place in Halkidiki peninsula in northern part of Greece were not so pious in their doings and contributed a lot towards tarnishing the image of Cypriots banks on the Greek island and worldwide. Vatopedi monastery on Mt. Athos needs no introduction among the Greece and Balkans regions. Monks here don't only hold significant political influence but also hold vast collections of precious artefacts. Centuries old traditions and their well connectivity enabled them to developed strong relationships with a number of leading institutions.

Location of the monastery is of significant interest as it easily accessible through the sea route because of its close proximity to the nearby busy ports. That's the reason why it became so important among celebrities, British monarch, Greek shipyard owners and Russian tycoons.

Orthodox Church is the biggest single landowner across the Greek Territory and Vatopedi monastery had special blessings which it allegedly used to swap vast stretches of land with the more valuable ones especially in Athens. The report says that about 260 such swaps were

completed (Ioannis Michaletos and Christo, 2008). Huge profits were later reaped and the proceeds were invested Marfin Investment Group which owned the Marfin Laiki bank.
Not only this, but Vatopedi monks had a great relationship with the Marfin Laiki bank which was also its biggest lenders. Figures suggest that they borrowed about €30 million from the bank to invest back into Marfin Investment Group shares and also they borrowed another €42 million to be invested in other investment schemes put in place by Marfin Investment Group in late 2008. Later inquiry was initiated and how the loans were processed critically questioned. Final reports indicated a total figure of €109 million of borrowing by the Vatopedi monks (Vatopedi linked to 4bn Loss, 2013). A judicial review pointed out the gains made by both the political and influential people as well as the Monks having close ties with them.
Being a Cypriot Bank and dealings like that, Marfin Laiki Bank made itself seriously questionable but more on than Central Bank of Cyprus and Cypriot government came under fire that how such large transaction were authorised given their suspicious nature.

Vasilikos Power Station:
Vasilikos Power station is located on the southern coast of the country and is the biggest source of electricity production for the country. It is also located next to the Evangelos Florakis naval base which serves as the main point for the country's Navy.
July 2011 was a dark day in the country's history as unfortunate incidents added to the already diminishing Cypriot economy. It met with a devastating explosion which destroyed the naval base with it as well.
Reason behind the explosion is cited as a shipment of gunpowder and other sorts of explosives which was confiscated from a ship in 2009, heading towards Syria from Iran (Massive Explosion at Cyprus Naval Base, 2011). Interception was made by the US navy and the vessel was of Russian origin and 98 containers full of explosives were detained.
Prolonged exposure to the heat detonated the warheads and the rest is history. The Economic disaster from the explosion is estimated to €2.4billion, about 14% of the Cypriot GDP while it also claimed 13 lives with it. Not only the immediate impacts had it also affected the country's long term ability of sustaining itself with prolonged power cuts and power saving measures. Airports and Tourist attractions felt the most pain which were to rely on their generators and alternatives for a short while.
Other after effects came a number of international credit referencing agencies downgraded the Cypriot profile significantly. Moody's argued the explosion has damaged country's mid-term prospects and brought down its growth from 1.8% to 0% as a result (Smith, 2011). Electricity prices also increased significantly to 660million, and Cyprus being the most expensive in terms of consumer electricity costs certainly didn't wanted that in the crisis times.
Serious questions were posed on Cypriot authorities after the disaster including:

1. The insurance of the Electricity authority of Cyprus was worth €1.9 billion but a clause limited it to only €600million for a single such event. Why this significant clause wasn't negotiated and communicated clearly by the authorities involved in organising financial aspects of the Plant as it was the backbone of the country electric supply line (Mullen, 2013).

2. The containers were stored there for more than two and a half years and government failed to take steps to remove the material from such a delicate spot. Several propositions were made to move the containers to either UK or US but were declined fearing an adverse reaction from Syria and Russia (Another Less known reason, 2013).

2008 Election:

As discussed both economic and political problems did play their part in bringing the Cypriot system down. One of such issues was the election of 2008. Cypriot economy was doing comparatively well at that time and the present government provided a 3.5% surplus with more good news to follow if the fiscal policies stayed untouched (Orphanides, 2013).

But Cypriots chose to solve the political instability which has been plaguing the region since the Turkish invasion of 1974. Sitting government was unable to resolve the issue and people from both sides wanted the reunification of island. Elections marked the victory of communist party AKEL and the initial progress along the proposed peace talks was satisfying which marked the new crossing in the divided capital, Nicosia.

After the rejection of 2004 Annan plan it was a brightest hope for the people and the agenda was actively backed by Turkey and both parts of Cyprus. Developments were also much liked because of the ideas of single international identity but with two separate constitutional states (Reunifying Cyprus, The best chance yet, 2008).

However the new communist regime not only failed to fulfil the promise of reunification but also led to some catastrophic measures such as authorising banks to further invest in Greek bonds which led Cyprus to its financial demise.

Laiki Bank & Emergency liquidity Assistance:

According to the European legal framework, ELA is a mechanism to supporting banks in crisis situation by providing them with funds that they cannot obtain otherwise. But there is protocol that needs to be followed before funds are granted and most important of these rules is to look out for the Solvency of the bank and the adequate collateral (or securities) the banks possess. The credit is issued by the Central bank of the respective country in agreement with the ECB which also is the major provider of the funds.

ELA method has come under severe scrutiny in the recent years because its inability to control the catastrophic financial events. In the case of Laiki bank it was used in a completely wrong way. Basically the idea utilized was to delay the insolvency of Cypriot banking system by as much as possible.

Central bank of Cyprus announced the ELA for Laiki bank in April 2012 for an initial €3.8billion. But it proved insufficient and it kept rising to €5.7billion in May 2012 and to €8billion in June 2012. By the time the Eurozone countries decided to shut the program Laiki already had received €11.4billion in ELA funds (Anastasiou, 2014).

Huge provision of such funds that ultimately went defunct was a huge question mark on the face of Cypriot government. Later studies revealed a different picture when a letter from the Cyprus President Nicos Anastasiades to ECB president Mario Draghi was leaked stating that they already knew the Bank is not solvent anymore and the funds that are being issued are for

other purposes including a smooth transition of the governments and to make the election possible (Sinn, 2014). This was a desperate attempt to salvage what was left and the decision makers thought the regime change was the only way forward.

In other words the funds were wrongly utilized to bail out the preferential creditors of the bank just in time and to delay the international Cypriot bail out rather than to prevent and replenish the void created by mass exodus of deposits from the Laiki Bank. Preferential creditors being industries and other major financial institutions that were thought integral to the economy were given their money back in order to support the rest of the stumbling economy, a decision that way wrong in every way.

ECB later upon the ultimate dissolution of Laiki bank started criticizing the Central Bank of Cyprus that they should not have issued the credit to a bank that didn't meet the minimum Euro Capital Adequacy requirement of 8%. But in fact ECB is also to be blamed equally as they could stop the ELA through their intervening powers and had it been stopped situation was much more manageable for the island country (Hailis, 2013).

7. GREEK BONDS:

Post 2008 the last and most deadly nail in the coffin is thought to be the Cypriot Banker's decision to invest in Greek Government Bonds. Greece like many other Euro nations came under severe crisis in the late 2000s and had to be internationally bailed out to rescue its economy.

August 2010 saw one of the biggest bailouts of the history when €110billion was awarded to Greece to support its tumbling economy. At the very same time situation was not as bad in Cyprus and surprisingly the two biggest banks of Cyprus and their Risk officers were willing to invest further in Greece. Germany and France clearly had declared that the creditors of troubled nations will take a significant cut in their portfolio no matter what.

Figures:

How much was actually been invested in Greece? Is often the first question that springs to mind. In 2010, €18.9 billion worth of loans were given to Greek Residents and that was about 27.8% of the total loans in issue by all the Cypriot Banks. After the first Greek default about 27% of all the Loans issued by Cypriot banks were none performing. Greek were also

accountable for 18.7% of total deposits in Cypriot banks but when we compare the figures with other Non-EU residents they only have 9.7% of total loans issued by Cyprus banks and deposits are also more than 20% of the total (Foxman, 2013).

Bank of Cyprus and Laiki Bank:

At the start of the year 2010, Bank of Cyprus and Cyprus Popular Bank had amassed a combined portfolio of about €4.7 Billion in Greek Government Bonds and despite of the bad situation they still kept investing and less than a year after they had €5.7 billion of bonds (Enrich & Forelle, 2013) whereas institutions like Barclays were reducing the investments they had in Greece. That's about a third of Cyprus's total economic stats.

As of June 2011, the Total Exposure of local Cypriots banks to Greece amount to a whooping €28Billion out of which about 5bn belonged to the government bonds and the rest was the loans issued to Greek residents (Foxman, 2013).

So as a result when in 2012 Greece Again Faced the Trouble, both banks paid for their mistakes and took a combine hit of €4.3 billion on their holdings.

European financial crisis are coupled with some other issues that complicated the Cypriot-Greek problem a bit further. Euro is governed by ECB and other financial regulations are overseen by European Banking Authority. But ECB doesn't have the authority to print currency and save the banks and European banking Authority cannot borrow funds to save the financial institutions. They both rely heavily on stable and healthier European economies like Germany to come forward and save the day. If the control was not in hands of a few nations Cyprus's Greek Bonds problem could have been sorted out much earlier.

Aftermath:

Cyprus Security and exchange commission imposed fines and penalties to the board members and high ranking individuals of both Bank of Cyprus and Laiki Bank with total amount of fine rising up to €7.5 million. Officials were blamed for their wrong doings including falsifying the facts and figures of the actual Greek bond holdings and authorising the deals to buy the bonds from other European banks when they were trying to get rid of their Greek bond holdings (Cyprus' SEC imposes fines on banks, 2014).

8. TROIKA AND THE BASICS OF THE AGREEMENT:

Troika is the negotiating committee that discusses the financial packages for the troubled nations and comprises of the three pillars of European economy i.e. the European commission, International monetary fund and European central bank.

The package discussed after a long and hard discussion was somewhat of a surprise and didn't go well on the Cypriot pockets. Finally troika and Cypriots reached on the agreement in March 2013 as Cyprus was not left with any other option but to go with the Troika put on the table.

A valuation of €17.5bn was made which was required to get Cyprus out of the mess. But instead of lending all the funds an interesting experiment was introduced that never happened before. Troika agreed on a loan of €10bn but the rest of €7.5bn had to be raised from within

Cyprus and that could take a lot of doing, given the economy is already stumbling (Theophanous, 2013).

Memorandum of understanding was signed and an interest rate of 2.5% to 2.7% was agreed with the repayment terms set over 12 years however Cypriot government could settle the loan earlier if it wanted so.

The basic constituents of the memorandum which will be introduced over a period of time are below:

Taxation:

Corporate tax rate was to be increased from 12.5% from the previous rate of 10% but the real shock came for those who were reliant on interest from their deposits as they were to pay a special contribution of 15%-30% of the interest income they received (Cyprus and Troika reach agreement, 2013).

The following significant tax treatments remained unaltered though.

Exemption of dividends from tax regardless from where they are received, Cyprus or abroad.
No capital gains tax was to be implemented on the sale of shares.
Allowable deductions on interest expense of loan for acquisition of 100% stakes in the company unchanged.
Double tax treaties would still be in place.

Other Fiscal measures:

Civil servants were to face a cut of 1.5% in their salaries in order to save those were employed on temporary basis across different sectors.

Semi-governmental institutions were to be privatized for the coming 5 years but the natural resources and their extraction will be controlled by the Cyprus government. However it was agreed that the portion of proceeds from natural gas will contribute in the loan from EU (Cyprus Financial Crisis, 2012).

Banking sector:

Restrictive measures regarding banking activities were to be put in place controlling and monitoring the cash flow necessary for the survival. These measures included prohibiting the cash withdrawals and maturing fixed deposits were to be renewed. Capital movements were also put on hold initially but all these control steps were relaxed with the passage of time. Banking sector was agreed to be reduced, Cypriot banks were to seize their operations in the Greek territory for the sake of both countries and two largest banks in Cyprus were restructured which will be explained later in detail.

9. THE ECONOMIC ADJUSTMENT PROGRAM:

Upon agreement between all the parties an economic adjustment program was created from the points above mentioned in the efforts to revitalize the economy. Following the memorandum was approved in April 2013 the details of the program were laid down.
A number of key short and medium term areas were addressed in the program and was having the 5 main blocks:

1. FINANCIAL SECTOR REGULATION AND SUPERVISION:

Liquidity in the banks was to be closely monitored with banks will be submitting quarterly plans to Central bank of Cyprus and ECB which will clearly reflect the measures to reduce the reliance on Central bank finance without causing any strain on the routine activities. Liquidity requirements for the banks were also be re-outlined as the liquidity of only 20% of Euro deposits was way too less and allowed the Greek debt to rise to an unmanageable level[3]. Deposits from non-residents in Euro were also to be subjected to higher liquidity requirement along with their deposits in foreign currency.

Capital was focused specifically after ensuring measures for liquidity. Capital adequacy requirements were made stricter and under-capitalized financial institutions were required to present short and long term plans of how they think to recapitalize themselves. Furthermore in case of such a crisis bank shareholders and other debt holders will take the cuts before government aid can kick in to safeguard the ordinary tax payer.

EU and ECB were more involved in the sensitive matters like the troubled institutions and their viability and particularly their financial restructuring plans.

Due Diligence was also equally emphasized as the portfolios of the largest banks were to be checked regularly including their overseas operations. Target was to evaluate at least 75% of the Cypriot banking sector and for that purpose an independent consultant was to be appointed having direct access to all the information. The review obtained will be reviewed further by a steering committee comprising of Cypriot authorities, European Commission, ECB, European banking authority and IMF. Review will further outline the basics of the stress test which will be applied on all the banks.

Supervision and Regulation of the banks and other credit institutions will be undertaken with extra care and special consideration here will be given to the recovery of the non-performing loans. The measures and steps to seize the loan collateral such as properties were to be made simpler and resale of such collateral was to be made possible in as short as 1.5 years.
Also the classification of non-performing loans was amended and all those loans going past the 90 days due date had to be classes as so, to have an exact outlook on the profitability of

[3] Liquidity was to be maintained to help fund the near future obligations like withdrawal of deposits in any other phenomena like the one Cyprus just experienced.

the banks. A centralised register of all the borrowers from both the banks and the credit institutions was to be created to monitor the level of borrowing and the new loan applications.

Cooperative credit institutions have always been prone to poor regulatory requirements despite having a significant stake in the domestic economy. Supervision of such institutions were segregated previously but now the Central bank of Cyprus will take all the responsibility and will review the independent audit report from the external auditors which is now compulsory for cooperative institutions. All in all the standards of will be made equivalent to those of commercial banks.

An Asset management company, Cyprus Asset Management Company (CAMC) will be set up specifically for the purpose of identifying and dealing with the bad assets (non-performing loans) of the banks and the credit institutions. The company will have a special focus on the Greek exposures and the purpose of CAMC will be to maximize the return from the resale while making the re-availability of the asset as quick as possible.

CAMC itself will be highly regulated with a transparent governance structure within the organization and also the legal protection for the employees and directors will be ensured.

Financial transparency shall be pondered upon with the money laundering and anti-terrorist financing regulations to be revised. Increased coordination with the foreign authorities regarding such matters will be made possible.

FISCAL POLICY:

Fiscal policy of **2012** was designed to bring down the trade deficit to no more than €700 million.
Controlling the remuneration in public sector was the major aim with wage structure was to freeze further up to 2015. Vacant positions in the public sector were also not to be filled with the 13th salary was to be written off completely.

Revenue measures included increasing the excise duty on the luxury products including wines and tobacco.

Fiscal policy of **2013** was designed to bring down the trade deficit to no more than €440 million.

Benefits and allowances of the public sector employees were to be targeted here including redundancy benefits, Christmas and Easter allowance were abolished. Housing related schemes were also severely affected and were much reduced.

Revenues were enhanced by increasing the VAT to 18% from the previous 17%. Property tax collection and public sector fee were specifically emphasized.

FISCAL STRUCTURAL MEASURES:

Pensions were among the affected areas among the fiscal structural measures. Rapid changes and any increment among the pensions will be stopped and pensions relating to the government sector will be brought down.

Voluntary early retirements will be subject to penalties in the pension and the minimum period of contribution will be increased to 15 years from the current level of 10 years (Kontolemis, Matsi, Stavrakis, 2008). A monthly cap on the maximum amount that can be received was also introduced.

Healthcare industry was also looked into with stricter control measures were introduced like allocating budgeted funds to individual hospitals and continuously revising the health policy.

Debt management included encouragement of long maturity financial instruments and revised assessments of the government guarantees which would enable develop a more prudent strategy.

State owned enterprises were to be targeted for some significant measures as well including creating a pool of Assets owned by such enterprises used to evaluate whether the particular organization needs divestment. Other measures included the preparations of plans that needed to be submitted in parliament about strengthening the governance within such organizations and budget to control the operational costs of state owned enterprises.

Tax compliance was to be rearranged in more than one way like establishing a special unit dedicated to monitoring and collecting the tax relating to the high net worth individuals. The tax administration entities were also to focus specially on the tax payable and the actual tax collections. Electronic tax submissions and payments must be emphasized more and bank transfers to be encouraged and steadily replace the cash and cheque payments.

Welfare system was obviously to be reformed following the credit crash and changes included targeting the most vulnerable who needed benefits and merging a number a benefit schemes to reduce cost. Those beneficiaries who were provided under multiple schemes were to be singled out and a cap to be introduced about the amount those beneficiaries were claiming. Eligibility conditions were also stiffened.

LABOUR MARKET:

Labour market and the reforms relevant to it posed a real concern as Cyprus used to enjoy high growth both because of quality workforce and low unemployment rates throughout the island. Following measures were taken:

Wages and salary indexation in both public and private sector were to be eliminated. Minimum wage structure was carefully reviewed however with special attention towards lack of competitiveness and quality of work, if the wage structure was to be altered. Consent from Economic and labour development authorities were to be obtained in order to change the minimum wages.

GOODS & SERVICES MARKET:

Trade was to be reinforced to get Cyprus back to its feet and in order to do that goods and services were an important area to focus on.

Product-Market Efficiency was to be enhanced by increasing competition in untouched areas of trade, reducing cost to the small and medium businesses by taking initiative to remove some of the legislative costs and making telecommunication more accessible.

Legislations relevant to specific sectors were to be brought down to a more lenient level and the use of commercial communication was to be axed from the compulsory list of regulated professions.

Title deeds of the housing properties were to be closely reviews and monitored throughout the process.

Tourism sector obviously was one of the most talked about area because of its importance and a number of cost saving measures including halt in further recruiting of hotel and resort employees was implemented. Supporting measures like better sewerage facilities and lower electricity tariffs were also introduced for hotels.

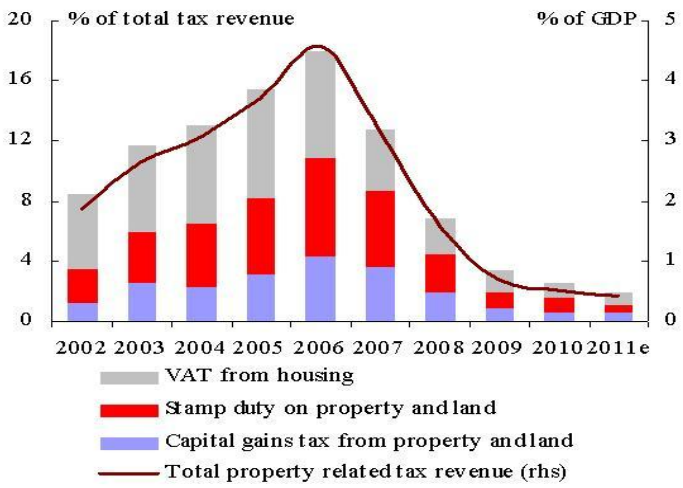
10. CYPRUS FINANCIAL HARDSHIPS AND OTHER NATIONS:

Ireland:

The similarities between Cypriot and Irish crisis are far reaching and depict the initial situation of the Euro zone.

Much like Cyprus, Irish housing boom is considered the main reason behind the crash. In the mid-1990s Irish economy suddenly picked up and outperformed its European neighbours by a long distance. Well educated workforce, high productivity and low corporate tax rates are the reasons behind this rise. By the advent of 2002 Ireland had an astonishingly low unemployment rate of just 4%, which is considered equivalent to full employment by the economists (Ireland's Economic Crisis, 2012).

The situation began to change abruptly after that when labour productivity decreased significantly and much of the fiscal growth in GDP was related to Property. It wasn't just about the Stamp duty and capital gains tax on the levied on the real estate but included everything like VAT paid by property developers and income tax payments from the workers in construction industry which narrowed down the tax base.



(Ireland's Economic Crisis, 2012)

By 2007, housing market was fully saturated and Ireland began to experience increase in the unemployment. Banks across the island country started to report loan defaults and the short term inter-bank finance became extremely difficult to access supplemented by the huge outflow of deposits. Deposit fleeing trend was closely in correlation with Cyprus as Ireland also had a huge amount of Foreign Direct Investment (FDI) flowing in every year and international investors suddenly started emptying their offshore accounts.

Government tried to intervene with blanket guarantees for the banks and to revitalize the banking system through public funds but met an epic failure and only managed to further increase the deficit.

Ireland and Cyprus also had this common tragedy of panic and negative perception. Irish economy was still more or less in a survivable shape but panic and restlessness spread swiftly among the general public and banks went bust.

November 2010 came with devastating news when Irish government was unable to borrow anything from the international lenders with the government bonds as collateral. The interest rate on Irish government bonds jumped up to an unsustainable 9% and Ireland had to enter the bailout package with EU and IMF. The package was decided to be an €85billion with €17.5 billion will be raised from within Ireland (Ireland's Bail-out Exit, 2013). When looking at the figures it suggest that only 20% of the required bailout was managed by Ireland itself with Europe bearing rest of the burden but Cyprus was singled out in this respect where 43% of the total bailout i.e. €17.5Bn was to go out from Cypriot pockets.

Iceland:

Iceland also shares a lot of similarities with the Cypriots. Apart from being an Island its similarity with Cyprus in terms of artificially inflated GDP and other factors put it right in comparison.

Iceland happened to be in trouble from right after the Second World War with Danish rulers not paying much attention to it. Further on it was controlled by an informal group of 14

Families[4] across the island which controlled much of the country's industries and consequently the economy. The narrowed economy was there until the start of the 90s when Government started to privatize the banks for the financial gains of the controlling families.

However it turned out to be a good step in terms of industrial growth at first. The uncontrollable growth started in 2003 when the increase in the GDP was reported to be 5.5% and Iceland was declared the third richest country in terms of per capita on the planet (Vaklimarsson, 2012). This increase was supplemented almost entirely by the unprecedented expansion of the three biggest banks in the country, much like Cyprus. Glitnir, Landsbanki and Kaupthing (Iceland's Financial Crisis, n.d.) were the banks that were the cause of all that trouble. Like Cyprus, the Icelandic Bank also relied on the foreign funds and despite being shut off from the European Union they turned to all the possible resorts like US, UK and Netherlands to borrow money against the government bonds. Total Assets of the Banks rose to a staggering 10 times of the GDP by 2008 (Hart-Landsberg, 2013).

This all was coupled by huge investments by the three banks across various sectors including US supermarkets, British Soccer teams and fashion chains across Scandinavia. Business activity boosted the share prices artificially and availability of easy credit also created a housing boom. From 2003 to 2007 house prices went up by an average 16.6% a year (Benediktsdottir, Danielson and Zoega, 2010). Foreign imports were on the high and spending by the people was way more than they could actually afford. Iceland bonds, sometimes referred as ''Glacier Bonds'' were acquired by the currency traders and resold on a much high interest yield.
Icelandic Krona was up there with the Euro but currency traders are often the first people who leave with the initial signs of the trouble.

The situation was relative to Cyprus when Banks failed to meet their obligation, the external finance dried up abruptly. Overseas operation of the banks which included the much debated Icesave Scheme was an instant hit and at the time of collapse was having $5.5bn of British and Dutch investors alone (What is Icesave Dispute all about, 2011).

In October 2008 all three banks failed and were taken over by the state. This triggered the mass crisis which engulfed everything from Stock market to currency depreciation and Housing crisis to unemployment.

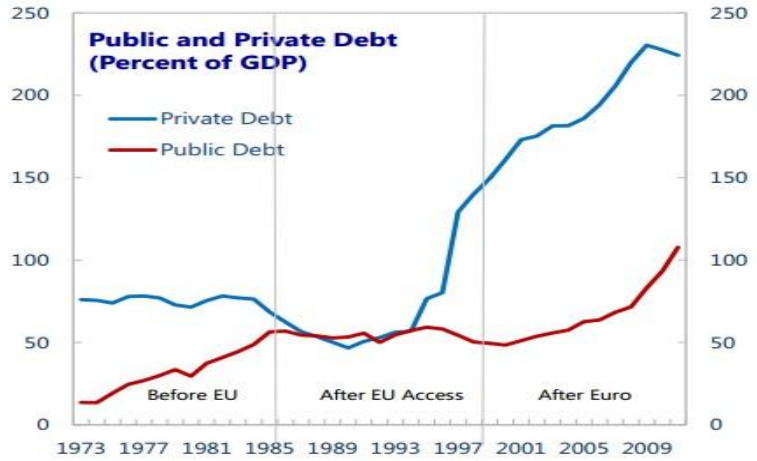
But the most surprising bit is there was no bailout or anything like that. Just a loan of $4.6bn in November 2008 from IMF and Nordic nations did the trick (Brogger & Einarsdottir, 2008) (not exactly). Iceland astonishingly didn't rely on the conventional bailout method but rather adopted a controversial approach which ordered the banks to forgive the mortgage loans to its citizens up to 110% the value of the property (Greenstein, 2013). This was coupled by strict action on the financial offenders which were thrown in prison. This method helped Iceland bounce back from the dead and has the lesson for Cyprus and Western nations as it is growing on a much faster pace than them.

[4] The families were known as ''The Octopus''.

Portugal:

Portugal is also one of the worst hit countries in the European crisis. A number of reasons in Portuguese crisis coincide with that of Cyprus & Greece which include:

Portugal's total debt (public debt + private debt) was huge, infact it was almost equal to its whole GDP. At the start of the year 2007 Portugal owed a staggering €165bn (Reis, 2013) to other countries making it one of the most indebted nations in EU jurisdiction. Greece is thought to be the most troubled country of all but Portugal's total debt was greater than that of Greece.



(Selassie, 2012)

Borrowing from other countries was a very alarming factor and the interest rate of Portuguese government bonds was highly unsustainable and the only one in the EU area after Greece offering an interest in double figures i.e. 12% (Sivy, 2012). After Greece was bailed out other countries learnt a lesson and decreased their interest rates on the Bonds but Portugal failed to do so.

Euro was adopted and it brought a number of good changes in 1999 but it also caused a number of current account imbalances.

Portuguese economy continued to shrink even when others were booming. A number of factors like extremely slow judicial system, reliance on Spanish markets and wage competitiveness[5] are responsible for that. The year 2012 saw the economy going further down by 3.3% (Sivy, 2012).

Consequently two of the Portugal's biggest banks were taken down and nationalized due to their malpractices, wrong investment decision and bad accounting procedures. Banco Português de Negócios (BPN) and Banco Privado Português (BPP) were taken over by Government in 2008 in return for their bailout but the decision wasn't worth it and contributed a lot towards an already limping Portuguese economy. Later on in 2012, BPN

[5] Portugal has one of the most expensive workforces in all of EU.

was sold to Banco BIC Portugues SA of Angola for a much reduced price (White & Reis, 2012).

After the collapse of much of the banking system and Government unable to pay off its international obligations, EU stepped in and a bailout package of €78bn (Tremlett, 2011) was announced. The scenario seemed highly synchronized to that of Cyprus in terms of the difficulties faced by the taxpayers. A number of Infrastructure projects were put on hold, State pensions were cut down, Private pension plans and funds were frozen and wages were brought down to a much lower level. However strict cost cutting measures and sticking to the austerity plan drafted by EU Portugal was finally backed into the capital markets in 2013, a much quicker recovery.

11. PRESENT CONDITION AND ROUTE TO RECOVERY:

Cyprus no doubt has been on the road to recovery after a few grim years in its history. But it has definitely pulled off a modern day financial miracle after it began recovery just after a year the banks went bust.

The story of the rise begins with the sacrifice from the top. Previous Governments and their fake promises were realized by the people and right after the crises they made no mistake in choosing the right people to lead the country. The newly elected government and its ministers took the pay cut of 45% with the low category workers working in the government sector were hit by just 6.5% (Evans-Pritchard, 2014). Anyone earning less than €1000 was spared from the wage changes.

Government and the finance ministry worked in close coordination with Troika and EU and strictly abided the code of conduct outlined in the memorandum earlier. Positive steps from the government also ensured the Economic Adjustment program and its clauses were properly implemented throughout the country.

Special measures and great marketing campaigns ensured that Tourism wasn't hit hard by the aftereffects of the financial instability. It remained strong and represented 7% of the economic GDP in 2014 with Russian visitors being the special contributors once gain. 25% increase in the Russian tourists was predicted at the end of the year 2013 and it fulfilled its promise and more than 800,000 Russians came in for pleasure (Russian Tourists, 2013).

Another key contributor in the Cypriot economy, shipping industry, also stood firm in the difficult scenario and maintained its position at least. Cyprus has the world's 10th biggest merchant fleet with an estimated 2,200 vessels and a capacity of 50 million tons (Shipping, n.d.). But surprisingly none of the shipping company operating in Cyprus left during or after the crisis.

Start of the year 2014 brought good news when capital controls within the country were being relaxed as announced by the finance ministry. However transfer of funds outside the

country was still restricted and without a reason funds couldn't be moved outside and time deposits cannot be withdrawn before the maturity term. However lifting the controls earlier than planned demonstrated a positive progress (Smith, 2014).

The industrial sector kept growing in numbers and the new companies kept on coming in the Cypriot markets because of the priority treatment towards the investment sector. The number of new companies registered in just April 2014 amounted to 1,018 (A retrospective in the Cyprus Banking crisis, 2014) bringing the total to more than 275,000 companies operating in the Cypriot territory.

Another important point is about the Tax relating to intellectual property. While in difficult times Cyprus is still encouraging the Research and development and has successfully maintained the low tax rates of below 2.5% on the gains relevant to Intellectual property (Driving the change, n.d.). Along with being one of the most attractive tax regime across Europe in terms of Corporate tax, Double taxation treaties has also been kept intact as still there are 46 treaties in place as before and no country has withdrawn from the arrangement amid fears from Cypriot situation.

The General perception was that Cyprus wouldn't hold on but as praised by the European commissioner for economic affairs in 2013 where he added '' the republic's economy has been resilient than expected''. International Auditors also saw the progress and stated that all the measures during the fiscal year 2013 had been rightly implemented with output from the economy only contracted by 6%, where 8% was anticipated earlier (Smith, 2014).

The Huge reservoirs of natural gas east of Cypriot Coast are a point of interest and attracting a wide range of companies ready to invest as they are the one the biggest of their kind in whole of the Mediterranean. Firms like Noble Energy, ENI and Total and trying to acquire the drilling rights of the site. According to an estimate there are 60 trillion cubic feet of reserves lying untouched and Cyprus Investment promotion Agency (CIPA) is eager to start work in the offshore field (Cyprus on a Recovery Route, n.d.).

Another positive development after the crisis is about the reunification of island. The present Government has shown bright signs of willingness to reunite the country. After the rejection of Annan plan this is the second time Turkish and Cypriot authorities are brought to the same table for discussion with US acting as the mediator. Cypriot president has emphasized on the greater collaboration with Turkish Cypriots and several sessions of talk are expected. Strategically it is important for Cyprus to be on the same page with Turkey as the Gas extraction process has been hit hard, following the threats from Turkey to take military action if the rights of Turkish Cypriots have been denied.

12. CONCLUSION:

Cyprus has unfortunately been one of the nations that fell below the critical line of financial health inside the EU. Throughout this paper focused on the issues that led Cyprus and its tightly knitted economy of less than a million people to a pitfall. Poor decision making on the part of banking authorities led to easy credit policies which in turn shaped out the miserable future for its financial industry. European Union and adopting the currency also didn't prove fruitful as it was deemed and interest rates merger was a drastic measure taken by the Central Banks.

It was just the fault of Cypriots but the whole world was struggling at that particular time which also put the situation in a more critical manner. Housing bubble like much of Europe did go burst eventually creating the initial void which couldn't be filled. On the other end of the world issues like Enron and Lehmann Brothers shook the credibility of the banks.

Some unfortunate incidents like the Naval base explosion and Vatopedi issue could have been prevented had some concerns been raised. But Government and other pivotal authorities turned the blind eye and let it all happen.

Further on The huge investment in the Greek economy was a major cause to fully plunge the country in the cave of crisis. Initial dealings showed profit but that's where a line should have been drawn especially when the rest of Europe was withdrawing their investments out of Greece. High interest rates lured the Cypriot Bankers and the two biggest banks went into restructuring.

European Authorities knew of the entire situation and could have helped Cyprus whose bailout was nothing compared to other nations. But the heavyweights of Europe were reluctant to spare a little more than €17bn and feared the protection of Russian money.

Consequently Cyprus underwent a financial surgery and uninsured saving deposits faced a haircut. This extra-ordinary experiment brought Cypriot people to its knees and it bailed itself in before it could eventually bailout.

Strict reforms were introduced and the country needed to abide by the code of conduct otherwise it all could go worse. Wages and Health structure were reformed and Pensions reduced a great deal.

But not only Cypriots proved to be a resilient nation but their recent recovery shows that everything is coming back to what it once was. It was only a matter of little more than 3 years when the economy was back to its feet. Recent rise of the financial sector, prudence showed by Government and fiscal measures should ensure that such a mishap will not happen anytime soon in the forthcoming future.

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