

## **THE ECONOMICS OF A SOLUTION IN CYPRUS – AN OVERVIEW**

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Distinguishing between the two major phases involved here is certainly a sine-qua-non in addressing the issues at stake as timely and effectively is needed. Equally important is also the distinction between the economic and the political, the positive and the normative dimensions and approach them accordingly.

The first phase is the implementation of the agreed solution. It involves possible compensation that will have to be paid in cash to the displaced citizens, mainly Greek Cypriots, as a reimbursement for their properties, in those cases where a return of their properties (reinstatement) or an exchange with another of comparable value was not feasible. At this stage major expenditures will also be needed to bring the infrastructure of the occupied territories returned to the Greek Cypriots up to the necessary standards. At the same time funds might be needed to pay for the movement of Turkish Cypriots currently occupying Greek Cypriot properties to new dwellings to be built for this purpose.

Subsequent to the economic crisis that erupted in 2013 in Cyprus, and the ensuing deterioration of the country's public finances and national debt levels, the funding of any of the above by the new federal state through additional borrowing should be out of the question. To avoid undermining the economic viability and stability of the new entity, any funding needed will have to come from overseas grants and certainly not new loans. The political dimensions of this issue could not be overlooked: a provision for the federal government to foot the bill will be deemed unacceptable by the Greek Cypriots as effectively forcing them, as taxpayers, to bear part of the expenses caused by the Turkish invasion.

In light of the events of more than half a century that brought the two communities to the current status quo and the agreement for a bi-zonal and bi-communal federation, any solution, beyond any doubt, is not expected to function as a 'transfers union', involving the transfer of resources from the financially stronger party (the Greek Cypriots) to the weaker one (the Turkish Cypriots). This being the case, all direct and indirect tax revenues raised in each constituent state will be at the disposal of the specific state. Any need to speed up the process of elevating the stage of the economic development and the standard of living of the less developed parts of the new federal state, mainly the northern Turkish Cypriot part, should be addressed by external entities like the World Bank, the IBRD and the IMF as well as by the relevant EU funds (Structural funds, Cohesion funds et al)

In addition to the above mentioned need for external contributions to the weaker party to narrow the existing economic divergences between the two constituent states, any tax wars between the states to solicit business from the other should be made illegal by the federal constitution. Apart from the tax homogeneity it should also be made clear upfront that there will be no internal financial or other barriers to trade between the two constituent states and other EU members as well as that the applicable EU common external tariff will be implemented by both states on imports from non EU members. Furthermore, any trade or other financial agreements signed by one of the constituent states with a third country should be made subject to the approval of the other constituent state, to rule out any unfair competition or detrimental effects on the latter and ensure both constituent states move on a common course.

The banking system and more specifically the harmonization of the banks in the north with the Euro system requirements poses probably one of the biggest challenges in the financial and economic integration of the two constituent states and the orderly financial functioning of the new federal state. The task is certainly simplified by the limited power and functions of the national central banks in the Eurosystem: the core monetary policy is in the hands of the ECB in Frankfurt with only the supervision of the local systemic commercial banks delegated by the ECB/SSM to the local central banks. The latter are only in full charge of the non-systemic local banks. This being the case, it is the ECB/SSM's duty to ensure that the banks in the north are duly assessed, especially with regards to their capital adequacy, and required to undertake any recapitalization needed prior to admitting them in the Eurosystem and assigning their supervision to the local central bank. Lastly, regarding the currency switch, to the extent that the Turkish Lira, which is currently employed by the Banks in the north, is freely traded in the international forex markets, the conversion of their currency into Euro should not pose any particular problems, as soon the banks are otherwise ready.