TROIKA FIXES FAIL: HOW TO FIX THE TROIKA

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There is no country in which the Troika could claim success. One is reminded of a situation where the doctor's prescriptions make the patient worse. The Troika policies can not be sustained without further strains in the Eurozone and the EU as a whole.

Participation in the Eurozone make it difficult for a country to pursue discretionary policies to address a serious recession as it has to stick to a balanced budget. This leads to the deepening of the crisis with further cuts in public spending and increased taxes. In effect we have a situation of automatic destabilizers! These policies in conjunction with a tight monetary policy lead to a vicious deflationary cycle. For the Eurozone to function there must be a system of fiscal support by the centre, a philosophy that is currently missing. As a consequence the country with the problem ends up with a considerably more difficult situation.

In this context it will be interesting to reevaluate the Cypriot case. Cyprus had a very pro-EU record: during the accession negotiations, polls had revealed a record level of Cypriots' pro-EU sentiments. This was related to high expectations from the EU; that accession to the EU would contribute to a solution of the Cyprus problem and that it would also help modernize social, economic and political structures.

Nevertheless, when Cyprus found itself in a deep mess due both to endogenous and exogenous factors the treatment it received was unexpected and extremely harsh. By 2012 Cyprus was facing a huge banking crisis, serious fiscal imbalances and a real estate bubble. Admittedly Cypriot policy makers and other stakeholders had engaged in imprudent practices with devastating results. But exogenous factors had also contributed: the international financial crisis, the Eurozone crisis and above all the haircut of the Greek debt in October 2011 during which Cypriot banks lost €4,5 billion – about 25% of Cyprus GDP.

Despite the very difficult circumstances, a different approach could have been utilized. In December 2012 the Cypriot parliament passed fiscal rationalization measures; salary cuts and higher taxes – a modest step toward the right direction. A new President, N. Anastasiades, had been elected in February 2013, committed to economic rationalization in consultation with his EU partners. It seemed at long last that it was possible to secure a rational stabilization plan. Rumours and press references about a bail-in seemed to fade. Nevertheless, Cyprus was treated in an irrational but also brutal and punitive way in March 2013.

According to ex-Foreign Minister of Spain, M. Moratinos, the EU acted myopically not helping Cyprus address the crisis; on the contrary, with the dictated policies it deepened the crisis.

The decisions of the Eurogroup were influenced by other considerations as well: these included the timing of the upcoming German elections, the objective to contain Russian presence in Cyprus, to use Cyprus as an experiment for future crises and to send particular messages to other bigger troublesome countries. Cyprus did not deserve this treatment. With such attitudes and practices the EU will not move towards integration. Apart from the huge solidarity deficit there are deep institutional, structural and cultural differences between the member states. Increasingly, several countries see Germany as hegemonic while the Troika is facing problems of legitimacy as its economic philosophy both in theory and practice lacks reason and sensitivity.

Eighteen months after the disastrous Eurogroup decisions of March 2013 the Cypriot economy remains in deep recession with the country suffering its worst demographic outflow since the Turkish invasion of 1974. The banking system has been seriously damaged with no new economic paradigm in sight. The Cypriot government and the Troika repeatedly expressed their satisfaction for "the progress made despite great obstacles ahead". The harsh reality though is that the economy is still shrinking. Stabilization, if it comes, will be at a low level.

It would be prudent if the terms of the agreement between the Troika and Cyprus are relaxed. Although it is important to continue the rationalization of the economy it is essential to reduce taxes, to enhance targeted spending and to encourage more liquidity. Reduction of taxes will stimulate economic activity, enhance consumption and investment and indirectly mitigate the situation of the non-performing loans. In this regard it should be understood that the payment of private and public debt cannot take place while economic activity is receding; foreclosures will not get rid of non-performing loans. The implementation of the suggested policy will not worsen the fiscal situation; tax rates will be cut but revenues will increase because of a dynamic process which will see reduced unemployment combined with a new approach of high penalties for non-compliance.

In relation to banking practices it is important to note that while in the past there were imprudent practices, after March 2013 strict procedures have effectively limited the granting of loans. This has a negative impact. Indeed we have passed from a state of great imprudence to that of suffocation. This should be reversed. Indeed the principle of the golden mean should be applied. Furthermore, given that the bail in was harsh and unnecessary, the EU should find ways to a compensate Cyprus with a specific (mini) Marshall type plan. Last but not least, rationalization plans should also take into consideration institutional arrangements and cultural considerations.

Cyprus aside, the economic conditions in other countries exposed to the Troika treatment are also problematic to say the least. In the case of Greece the socioeconomic conditions are harsh: unemployment approaches 30% despite the fact that many Greeks have emigrated; there is a huge fiscal cliff and deflation and decreasing salaries and pensions are creating suffocating conditions. Indeed "Greece is facing the depression of the century" according to Greek economist, Theodore Pelagidis.

Not surprisingly recessionary pressures are also reaching Germany. If the Eurozone's current philosophy and practices are not reversed, there will be further and deeper strains. It should be obvious that Cyprus, Greece, Spain, Portugal, France and perhaps others can no longer pursue the monetary and fiscal policy dictated by Germany.