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## **An NBF saga in Cyprus?**

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Who does not remember the National Bank of Fiji (NBF) saga of the 1990s?  
Who could forget the famous quote, “It is water under the Rewa Bridge?”

NBF disaster and the quotation would ever remind us how institutional governance failure, at the NBF board and at regulatory and supervision levels, led the bank management to abuse the depositors’ trust in them.

Why do we recall the NBF saga now?

Last week’s developments in Europe’s tiny economy, Cyprus brings us back to the nightmarish days of NBF saga.

All Cypriot banks were closed for ten days, from March 18 to 27 for averting a run on banks, once it was known they had no cash to meet withdrawals. Only the use of ATMs was allowed, but with a limit: not more than €100 or US\$ 130 per day.

Surprising thing is it happened under the nose of European Central Bank (ECB) in the 17-member eurozone (population : 330 million; GDP: US\$ 13 trillion). The euro was once touted to be a competitor to the US (population: 300 million and GDP: US\$ 15 trillion) dollar.

Cyprus (population: 0.8 million; GDP: US\$ 25 billion) joined the eurozone in 2008. It is small compared to Germany (population: 82 million and GDP:US\$ 3.3 trillion). Its GDP (US\$ 25 billion) is just 0.20 percent of total GDP of eurozone, whereas Germany’s GDP (US\$ 3.3 trillion) is 27 percent, followed by France (21 percent) and Italy (17 percent).

All along, Cyprus enjoyed prosperity, which flowed out of gains of single currency associated with mobility of capital, labour and goods within Europe and inflows of investment from the rest of the world until the Greek tragedy. While Greece was hit by rise in public debt, Cyprus was hit by bloated banks.

## **Money laundering?**

What brought the nemesis closer was the secrecy of Cypriot's financial sector, with its past popularity as an offshore financial centre since the 1990s. The close relationship, which existed between Russian investors (with their ill-gotten money) and Cyprus since the break-up of the Soviet Union in the 1990s grew stronger after 2008. Germany and ECB knew all these. Cyprus claimed that their financial institutions were strictly monitored.

More than 50 percent of Cypriot bank deposits are of Russian origin.

Russian investors also borrowed from Cypriot banks for setting up companies taking advantage of low 10% corporate tax rate and Russia's tax treaty with Cyprus, exempting the firms from payment of taxes in both places.

By 2011, loans and assets of Cypriot banks were seven to eight times of its GDP! Aside from investing in local government bonds, they also lent to Greek government and to private borrowers. Their loans amounted 160 percent of Cypriot GDP. Rapid growth in credit to domestic borrowers fanned the property boom also.

In their book on NBF saga, Professors Grynberg, Munro and White wrote that during the four years after 1987, NBF "introduced new services, trebled staff and quadrupled advances; and rapid expansion involved a relative growth of bad debts since the lending criteria favoured privileged groups".

The NBF saga case differs from Cyprus case in one respect: The NBF debacle is purely a domestic affair: no foreign depositors and no foreign borrowers!

## **Greek crisis and Cyprus trouble**

Greece's own debt crisis landed Cyprus in trouble. In the Greece bailout programme, the value of Greek government debt was cut and consequently banks of Cyprus had to face the reduction in their assets. That was the root of the liquidity crisis.

If Cyprus were not a member of the eurozone, its own central bank would have acted as lender of last resort and injected liquidity in the cash starving banks; and the government could independently print currency to save the banks for re-capitalizing and obtaining shares. Remember Fiji ran a budget deficit of F\$ 220 million to save NBF.

Cyprus has no control over its destiny and currency as it is shared with 16 others. There was no go. Cyprus needed to raise €5.8 billion (US\$7.5 billion) to qualify for a €10 billion (US\$ 13 billion) bailout from the EU, ECB and IMF. The original March 16 bailout deal required all customers of Cypriot banks to face a one-off tax on their deposits, starting at 6.75% for the smallest deposits and 10% above €100, 000, which were to be exchanged for bank shares.

The Cyprus parliament rejected the proposal. The levy was deemed as a punishment on savers. It is no secret that Germany was targeting Russian depositors. That was one way of controlling money laundering.

Cyprus approached Russia for a loan, which did not materialise. Another bailout deal was agreed on March 25. This time there was no mention of levy.

Two big banks (Laiki and the Bank of Cyprus) which had high exposure to Greek debt had to face action. Laiki Bank will be closed. Its deposits below € 100,000 would be protected but deposits above € 100,000 be moved to Bank of Cyprus. All deposits above € 100,000 will be frozen and used towards building up the required €5.8 billion for €10 billion bailout. Depositors are expected to lose 30 to 40 percent of their savings.

The banks were opened on Thursday March 28. Cypriots now face capital controls. These include (i) daily withdrawals limited to €300 euros; (ii) no cashing of cheques; (iii) travellers outside Cyprus cannot take more than €1000; (iv) payments by debit and credit cards limited to € 5000 per month.

These capital controls are expected to be in place for a month.

Temporary or permanent, these capital controls are against the spirit of the eurozone, the Nirvana of economic integration with perfect mobility of labour, goods and capital!