

Questionnaire sent by European Parliament to Minister of Finance

Question 1: If applicable, why did your country decide to request a financial assistance programme?

The Cyprus economy was subjected to successive downgrades from rating agencies. This was a result of a combination of unsustainable public finances, a problematic banking sector, as well as structural challenges that were exacerbated by the euro financial crisis. Eventually, Cyprus lost access to the markets in spring 2011, as interest rate yields on sovereign debt increased to prohibitive levels. With some delay, the then Cyprus government requested financial assistance in June 2012.

Question 2: What was your role and function in the negotiation and set up of the financial assistance for your country?

A Ministerial Committee, which was set up by the previous government, provided the political guidance on the main policy areas as well as directions to the various technical Committees responsible for financial, fiscal and structural issues during the negotiation phase with Troika. The Ministerial Committee included the Ministers of Finance (Chairman), Labour and Social Insurance, Commerce, Industry and Tourism, the Government Spokesperson and the Governor of the Central Bank of Cyprus.

The previous government preliminary agreed on a MoU with the programme partners at technical level in November 2012. Final agreement at political level was not reached until a change in government came by. The new administration took office on March 1st 2013, and an agreement was reached at Eurogroup Level on March 25th 2013. The Ministry of Finance had a leading role throughout the negotiating phase.

Question 3: What was the role of the national Parliament in the negotiation of the MOU? How did the Government present the text to the Parliament? How did the Parliament adopt the final MOU? Did social partners take part in the discussion on MOU?

The Troika had meetings with representatives of all political parties as well as with the Parliamentary Committee on Financial and Budgetary Affairs throughout the negotiation phase.

The former Minister of Finance had informal contacts with representatives of all political parties with respect to the negotiation phase in order to seek their views on a number of important issues. Similar contacts with representatives of political parties were also held at technical level.

The political system in Cyprus is a Presidential one, with a separation of powers between the executive and the Parliament. Thus, the Financial Assistance Facility Agreement (FAFA) was submitted to Parliament and the final MoU was submitted as an appendix to the FAFA.

-They were both ratified on 29.04.2013. It should be noted that the Parliament had rejected the original political agreement reached at the Eurogroup on 15th March 2013.

During the negotiation phase and before the finalisation of the MoU, numerous meetings were organised between the representatives of the programme partners and social partners. Under discussion were the issues pertaining to the challenges faced by the economy and how these could be addressed.

Question 4: How much leeway did you have to decide upon the design of the necessary measures (consolidation or structural reforms? Please explain.

-Negotiations regarding the MoU did not proceed in a timely and effective manner. Consequently, programme partners had formulated their own comprehensive macroeconomic adjustment programme encompassing

measures relating to the financial sector, public finances, fiscal/structural, labour market, energy sector and services sector.

Areas considered to be non-negotiable by previous government were the reform of Cost of Living Allowance, pension reforms, social welfare reform, privatisation, and the required fiscal effort. The issue of the timing of reforms was also debated. However, by November 2012 the previous government eventually reached a preliminary agreement with the Troika which covered most of the above issues.

Subsequently, the new government had only very limited time and scope to further negotiate aspects of the MOU. The most controversial aspect of the final negotiation was the application of the bail-in instrument on bank deposits. The Cyprus government was forced to accept this measure under duress.

Question 5: Do you consider that all consolidation measures/structural reforms were equally spared/divided among citizens? Please explain.

In relation to fiscal consolidation it is useful to refer to a recent study of the University of Cyprus which states the following:

“Overall, the first-round distributional shifts are the outcome of unemployment rise, falling wages and austerity. Unemployment places a heavy toll mostly on low-income households. On the contrary, austerity is progressively designed, targeting mostly middle and high income households. Thus, the final distributional outcome is the combined effect of two counteracting forces: unemployment which tends to increase poverty and inequality; and progressive taxation and/or cutbacks which tend to reduce relative differences between the poor and the rich. Of course, these two factors are interconnected. Austerity is responsible, at least partly, for the unemployment rise (for it hampers economic activity).”

With regards to structural reform it is expected that at least in some areas such as the Welfare and Health Care Reform there will be a positive impact on equality and social cohesion.

Question 6: Please describe the quality of the cooperation between your authorities and the Troika institution on site.

After the Eurogroup decision to apply the bail-in on deposits which was contested by the Cypriot side, a close and continuous cooperation between the Troika and the authorities of the Republic of Cyprus, has been established. In general, discussions are held on the basis of rational arguments and in a constructive spirit, with a view to meeting the programme objectives. The Support Group which has been established with the initiative of President Barroso in order to assist the Cypriot Institutions in technical issues that arise from the implementation of the MoU, constitutes a practical form of support to the Cypriot Authorities.

Question 7: What impact did the entry into force of Regulation (EU) No472/2013 have on the implementation of the programmes? Did you make use of the provision of the Regulation, particularly Article 7(11)? If not, why?

The entry into force of the Regulation (EU) No472/2013, on the strengthening of economic and budgetary surveillance of Member States in the euro area experiencing or threatened with serious difficulties with respect to their financial stability, allowed the Government of Cyprus to use the Article 7(8), which states that

“A Member State subject to a macroeconomic adjustment programme experiencing insufficient administrative capacity or significant problems in the

implementation of the programme shall seek technical assistance from the Commission, which may constitute, for that purpose, groups of experts composed of members from other Member States and other Union institutions or from relevant international institutions.”

More specifically, Cyprus has asked for technical assistance from various international organisations, such as the European Commission, World Bank, IMF.

The provisions of the Article 7(11), which states that “Representatives of the Commission may be invited by the parliament of the Member State concerned to participate in an exchange of views on the progress made in the implementation of its macroeconomic adjustment programme” have also been used, as the Commission (and also IMF, ECB) was invited by the Parliamentary Committee on Financial and Budgetary Affairs to discuss progress made on the implementation of the Programme.

Question 8: How many cases of infringement of national law challenging the legality of the decisions arising out of the MoU are you aware of in your country?

More than 5000. The vast majority of those are applications for judicial review filed against the decisions through which the Resolution Authority made use of the sale of business tool in the case of Laiki Bank and of the bail-in tool in the case of the Bank of Cyprus. On 7 June 2013, the Supreme Court handed down its judgment in 55 such cases that it treated as pilot cases. The Supreme Court dismissed these 55 cases as inadmissible, on the grounds that the relationship between the banks and their depositors is governed by private law, this fact remaining unaltered by the intervention of the state through the resolution measures. It was therefore held by the Court that the only remedy available to depositors is damages that they can claim through actions before the civil courts,

provided that they can prove that they have found themselves in a worse position than the one they would have been in had the state not intervened.

Question 9: Are you satisfied with the objectives and the effective outcomes of the programme in your country?

The Government fully acknowledges the need for fiscal consolidation and structural reform, as well as measures relating to the restructuring and recapitalisation of the financial sector. We are in broad agreement with the directions, the priorities and the contents of the programme for which we are claiming ownership.

Despite the serious side effects of the application of the bail-in instrument, which include the imposition of capital controls, the economic situation is stabilising and the banking system has exited the danger zone. Moreover, economic performance is somewhat stronger than what was originally assumed, as a result of a stronger resilience of key sectors of the economy. This, together with decisive measures in the direction of fiscal consolidation, has resulted in public finance remaining safely within targets. However it should be noted that the programme is still in early stages. The real economy continues to face major challenges. The severing of credit lines is bearing down on the productive sectors of the economy and unemployment is on the rise. The implementation of the structural reform measures which are included in the Cyprus programme are expected to have a long term positive impact and will establish the foundations for a much more viable and productive economy model for Cyprus.