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The Solution of the Cyprus Problem
and the Future of the Cyprus Economy
in a Changing Global System

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The Solution of the Cyprus Problem and the Future of the Cyprus Economy in a Changing Global System¹

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¹The paper is based on an edited version of a talk given to a Discussion Forum organised by the Cyprus Economic Society on 17 November 2016. Mr George Vasiliou was the guest speaker.

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Abstract

This paper is based on an edited version of a talk given to a discussion forum organised by the Cyprus Economic Society and focuses on the economics of the solution to the Cyprus problem. It considers the costs and risks of no solution, the benefits and advantages of achieving a viable and workable solution, and the implications of global disruptive forces. A solution has to be viable and workable as a precondition for economic success. For a solution to be achieved two basic elements must be in place: the will to compromise and the ability to forgive for the crimes of the past. An outcome of 'no solution' is not innocent. Every time an opportunity is missed the problem becomes more complicated because the realities on the ground, including demographics, change. A 'no solution' will also increase the sense of disappointment and insecurity, and this in turn will act as an obstacle to investment, both domestic and foreign. In contrast, a solution that unifies the economy can achieve larger economies of scale, remove many of the current impediments to investing, and bring valuable real estate into full commercial and economic use. Sectors such as tourism, education, international business services, energy and shipping can be expected to benefit immensely. In the global system there are dramatic changes taking place driven by four fundamental forces: the acceleration of technological change; the shifting of economic power to Asia, especially China; the demographic transition to an ageing population; and the increasing interconnections and interactions in the global system. Remaining burdened by a political problem of occupation and division, and all the uncertainties this entails, will result in long-term stagnation, which will be to the detriment of all the people of Cyprus.

Key words: Cyprus problem, security, status quo, Anan Plan, foreign investment, demographic threats, bizonal bicomunal federation, global system, disruptive forces

JEL Classification: O47, O50, P14, P26, Z32

1. Introduction

Dear friends,

I am very pleased for the opportunity I have to be with you tonight and speak about the subject that is in everybody's mind at this moment "The solution of the Cyprus problem and the future of the Cyprus economy in a changing global system".

Before I proceed further, I would like to congratulate the Bank of Cyprus, for the fact that they had submitted an application for listing on the London Stock Exchange. It is the first time that a Cypriot company is aiming to list on the London Stock Exchange. This means the Bank will be under the strict regulatory and reporting requirements of the London Stock Exchange and will be constantly analysed and compared within a peer group of other similar banks of European and international acclaim. The impact on the bank and by extension on the economy at large will be significant. For this reason the listing on the London Stock Exchange is a hallmark of success and adds to the credibility not only of the Bank of Cyprus but of the country also. I therefore extend my sincere congratulations to the Board, Management and Staff of the Bank of Cyprus, for making this a reality and for working hard to raise the Bank to a higher level of performance.

Reverting now to the subject of today's meeting I can justifiably state that by choosing the title for my presentation 'The Solution of the Cyprus Problem and the Future of the Cyprus Economy in the Context of a Changing Global System'- you are assuming that the Cyprus problem can be solved. You are therefore justified in asking 'how can we succeed?'

Many years ago, in 1989, I had the honour of meeting President Nelson Mandela, who, soon after he was released from prison, had succeeded, in a relatively short period of time, to solve a problem that the whole world was afraid of. So I asked him, what was the secret of his success? "First of all", he said, "you have to decide how you want to solve your problem; peacefully or by war? If you choose war then you must be ready to face the repercussions... In South Africa we had considered the options very carefully and we said no, we don't want war. We don't want to kill one million whites, and we don't want the whites to kill one million blacks. What we want is to succeed in uniting our country, not

geographically, but between the two major communities, the whites and the blacks. So we decided to find a peaceful solution. From the moment you decide to reach a peaceful solution, it means you are ready to compromise”.

The second condition is to be able to forgive for the crimes of the past. “We suffered more than any other nation any other group of people”, Mandela said, “... but we decided that we wanted to live in peace in the future and so to put the past behind us”.

I remember the then leader of the Turkish Cypriot community, the late Rauf Denktaş, during our negotiations, would always revert to telling stories about how much his people had suffered. Why? Because he was not prepared to compromise and was using the past in order to justify his position. On our side also, we looked at what the Turks did to us during and after the invasion in 1974. With our unanimous proposals of 1989 however, we proved that we were ready to compromise and to work towards the creation of a Bi-zonal Bi-communal Federation. As Mandela clearly pointed out “You can never reach a solution if you cannot put the past behind you”.

Unfortunately in Cyprus, the leaders of the so called “patriotic front” have not been able to accept this simple lesson. Thus any future agreement will not be accepted by them and they will reject it in whole or in part, in terms of specific sections. This should not surprise us because a number of our politicians dream that we could revert to a pre-1974 Cyprus. A solution however, cannot be based on dreams but on realities.

I am not saying that any solution is better than no solution. A solution has to be viable and workable and appeal to the security concerns of both communities at the same time. What we need to realise though, is that the ‘no solution’ scenario is not innocent; in fact it entails serious risks for the future of Greek Cypriots on the island. For this and other reasons, we need to approach efforts for a negotiated solution positively and with sincerity toward the other side. We must put the past behind us and pursue a viable and workable solution with a sense of urgency and an understanding that to get there both sides will need to compromise.

If we study the history of the negotiations for a settlement on this island, there is a familiar pattern. We start cautiously, then optimism rises, and in the end we have stalemate. I am not going to go into the details of the negotiations tonight.

This is not the purpose of our meeting. I want to stress the importance of time, discuss the economic outlook after a solution and the consequences of no solution. Doing so will also allow me to highlight important parameters of the solution that sometimes elude us all.

2. The Importance of Time

Even today many insist that we should not negotiate: They say it is better to wait until things turn to our favour and then we will dictate our terms.

We have learned, however, that this dream is not innocent but very dangerous and expensive. If the negotiations do not lead to a solution then the status quo continues. Such an outcome always favours the stronger party i.e. Turkey. This is exactly what happened in Cyprus.

They believe that with the passage of time, in some miraculous way we will succeed to impose our will. We are doing so well they claim, "Why do we need to compromise?" But because we may be doing relatively well now, there is no guarantee that we will be doing so in the future also. Can we really know with certainty what the prospects of a permanently divided Cyprus will be? We are not the centre of the world. The world does not revolve around us and is changing at a very fast pace. Therefore, if we insist in believing in miracles, we will simply fail! This is why a search for an agreement, in my opinion, is a vital precondition for everything else.

Some may say "you are trying to blackmail us George because there will always be another opportunity". They will even remind us that the same arguments about the need to compromise were made when the Ghali Set of Ideas and later the Annan Plan, were discussed. They fail to understand how realities on the ground change every time we miss an opportunity to achieve a solution. When the Anglo-Canadian-American plan was presented, no illegal 'state' existed in the north. When we rejected the de Cuellar proposals, there were very few settlers. When I was President I had proposed accepting 20.000 settlers after a solution, out of a total of around 50.000 then working in Cyprus. At that time I was accused of being a traitor. When the late Glafkos Clerides was President, he had accepted that 50.000 Turks could remain and he was also called a traitor.

Today, 13 years after the referendum on the Annan Plan, we do not even use the word settler any more. People who had come from Turkey many decades ago, got married here, and now have grown up children and grandchildren do not see themselves as settlers. The reality of settlers today is vastly different from what it was 20, 30 or 40 years ago. None of us likes this situation, but there is little that we can do about it and certainly we cannot ignore it.

Let me give you another example of what the passage of time means. When the Anan plan was presented, Turkish Cypriots residing in Morphou at the time, were prepared to leave and be resettled somewhere else. The advantages they perceived at the time far out-weighed the problems they would encounter from relocation. Morphou was a non-issue in 2004, but now it has become a major one. The history of the past 40 years is the best proof that the status quo benefits the strongest party, and in our case the strongest party is Turkey.

3. Will an agreement be imposed?

Those who oppose the Bi-communal Bi-zonal Federation are complaining that an agreement will be imposed on us. Can an agreement really be imposed on us and by whom? It will not be by the United Nations because if that was the case, an agreement would have been imposed on us a long time ago. The two leaders are currently having intense discussions to come to an agreement. The United Nations are facilitating the process. The Special Adviser to the Secretary General for Cyprus, Mr Espen Barth Eide, is not supposed to make any recommendations. The negotiations are “Cyprus Owned” and if we fail we will have to face the repercussions.

4. The Dangers of No Solution

Like I said in the beginning of my speech, a ‘no solution’ scenario is not innocent.

- First of all there will be huge disappointment by the citizens of both communities and increased anxiety and fear about the future. In a small island, like Cyprus in the midst of a region of the world that is up in flames, you cannot really expect any serious foreign investment and even Cypriots would try to save as much money as possible rather than invest it.

- Lack of a solution will lead to insecurity. Everybody will worry as to what the future will be. You are all business people and economists in this room. You understand very well that the first principle for investing is the need for certainty about the future. Potential investors will always want to know how secure their investment is. If there is uncertainty they will postpone making that investment. I am also convinced that those who invested in Cyprus in the last few years did so because negotiations were progressing and they were hoping that the Cyprus problem at last will be solved. This is a truth that some try to ignore but they cannot. Best proof of the above is that despite its efforts, the Cyprus Investment Promotion Agency, CIPA, failed to attract any substantial foreign investment. (The €1 billion invested in the Bank of Cyprus, has to be attributed to the Bank's CEO, John Hourican.)
- Our children, after completing their studies, will try to find work somewhere abroad since in Cyprus they will have few chances if any of being employed and no certainty about the future.
- The embargo on ships registered or managed from Cyprus will continue, making it extremely difficult for the Cyprus shipping industry to develop further and take advantage of the new opportunities.
- The international rating agencies will most probably downgrade us, if not immediately shortly afterwards.
- The hopes for recovering the Greek-Cypriot properties in the occupied areas, will practically disappear
- The banking sector will suffer and non-performing loans will rather increase than decrease
- The demographic threats for the Turkish Cypriot community will increase, as settlers will continue to come, and will be aggravating the already serious situation they face.
- Finally we must point out that the international community, already tired with the continuously unsuccessful negotiations of the last decades will give up hope. In these conditions we cannot be certain that the UN will be willing

to continue dedicating efforts and money to Cyprus, particularly since, as we know, the problems of migration, famine in some African countries, and conflict in other parts of the world, require their urgent and continuous attention. Can anyone guarantee that after so many failures the new UN Secretary General will be willing to continue investing so much time and money particularly since he now has to face much bigger problems than ours?

If one considers carefully these and many other issues, he or she will reach the conclusion that an agreement is necessary and a failure is not an option.

5. Can we afford a solution?

I am sure that you may all have heard the argument that “We all want a solution, but we simply cannot afford it because to compensate all property owners we will need 50-100 billion euro, which obviously nobody is willing to give us”. This is an entirely false statement which does not in any way correspond to the realities of Cyprus, we are a full member of the European Union and our Turkish Cypriot compatriots and Turkey have agreed that the future bi-zonal bi-communal federation will continue being member of the EU, which implies among other things the full implementation of the *acquis communautaire* and the four basic freedoms.

After a solution, it is obvious that many Greek-Cypriot properties will be located in the future Turkish-Cypriot federated state and many Turkish-Cypriot properties will be located in the Greek-Cypriot federated state. All owners will regain their properties and will be free to keep or sell them to the current users or others. Financing of these transactions will be ensured by a Property Board. The successful operation of this Property Board cannot be doubted since with the solution of the Cyprus problem all land values will increase considerably within the next 10 to 20 years and will easily cover the cost of any sales or purchases during the transitional period of reunification. (I know that this is a huge and difficult subject to talk about within the frame of our present discussions but I will be ready to answer any questions you may have and try to explain briefly our thoughts on this subject.)

6. What will be the benefits of an agreement?

The peace dividend, as I choose to call it is huge. I will give you only a few examples of why I say that:

- Cyprus is already experiencing a significant increase in tourist arrivals but the current numbers are very far from the potential of Cyprus. Crete for example, receives more tourists than Cyprus, and Dubai received 14 million in 2015. Instead of wasting our time fighting each other, we will be promoting Cyprus as a whole. Expectations are the numbers if arrivals and incomes from tourism can practically double compared to the current levels.
- For every one million of new tourists, investment in new hotels and relevant infrastructure will exceed three billion euro.
- Education is the other sector where one can expect phenomenal growth. Already, in Cyprus currently there are more than 100,000 students, around 35,000 in the Republic and more than 70,000 in the T/C administered area. With the solution Cyprus can become a Centre for education for thousands of people from the surrounding countries who wish to obtain a degree from an EU accredited university. Thus the objective of approximately 200,000 students per annum, after a few years, is not un-realistic.
- The development of the Greater Famagusta area could itself provide the opportunity for attracting around 1 million new tourists and will need investments for infrastructure and other purposes of several billion.
- Cyprus will become the centre for international companies which are actively engaged in exploiting the wealth of gas and oil in the Eastern Mediterranean. I do not want to make any forecasts on the potential incomes from the exploitation of our natural resources but everyone recognises that this can be significant.
- The shipping industry will enjoy a much better future, particularly with the removal of the embargo on all Cyprus ships the day after reaching an agreement.
- S&P Global as well as the other Rating Agencies will improve the rating of

Cyprus Bonds which will lead to a reduction of interest rates, and savings of tens of millions.

I could continue referring to specific benefits but I do not want to do that. I want to end this brief reference to the peace dividend by stating that the GDP, which currently for both the Greek-Cypriot and Turkish-Cypriot is around 21 billion, can increase to over 30 billion within the next 5 to 7 years.

As a result, unemployment will disappear and we might even face the need for importing labour while the multiplier trends for the retail trade and the economy in general are obvious to all of us.

7. What is the guarantee that an agreement will be implemented?

My answer is very simple. The agreement between the two communities will be strengthened by its unanimous acceptance by the Security Council and enjoy the full support of the European Union. Of course there may be disagreements and problems that one cannot envisage at this moment. But which country in the world has no such problems to address? The following examples illustrate this reality.

For a year and a half Belgium had no government. Their two main communities, the Flemish and Walloons, had their disagreements. But they kept on talking and talking until they found a solution.

Lebanon is another case in point. The country had no government for a long time but they had to find solutions and that meant they had to compromise. Well they did and Michel Aoun became President of the country and Saad Harriri Prime Minister.

In Spain also, they had a political deadlock when the election a year ago failed to produce a majority government. Spain was run by a provisional government until a solution to the problem was worked out.

The conclusion is that Democracy never fails. Disagreements will have to be worked out through dialogue and understanding. You sit down and you talk until you find a jointly accepted solution based of course on a compromise. The

statement that disagreements will cause the demise of the system we are about to create, is simply wrong.

8. The future of the Cyprus Economy in a Changing Global System

The second part of my presentation relates to the future of the Cyprus economy in a rapidly changing world. (That should be the subject of not one but several meetings of your Society). The world is changing so fast that it is difficult to visualize.

I will refer briefly to the four most important forces shaping the future, which are:

- a. Acceleration in the development and impact of technology
- b. Globalisation and the shifting of the gravity of economic growth and trade to emerging markets like China and India and most of Asia
- c. The demographic transition and the ageing of the population
- d. Changes in interactions and interconnectedness

Acceleration in the development and impact of technology

I start with an interesting story:

The emperor of China at the time was very happy with the invention of the game of chess and desired to reward the person who invented it. So he asked him what he wanted. The inventor asked for one grain of rice for the first square of the chessboard, two for the second, and four for the third and so on, doubling with every move to another square. The emperor was happy to grant him this wish because he could not visualise the results. In fact doing so for the first half of the chessboard was not very eventful. But for every move to another square in the second half of the chessboard the quantity of rice would soar. Moving over sixty four squares the total the quantity of rice that would be needed was immeasurable. In one version of the story the emperor went bankrupt.

When I established KEMA in the 1960s, I was probably one of the first to use a computer. I remember we needed a big room to accommodate it. Fifty years later, one of those smartphones in your palm has more processing power than our huge IBM mainframe had in the 1960s.

This is what is happening as a result of the acceleration of technological development at the moment. As an expert commented we are currently in the second half of the chessboard. Change and growth will be astonishing.

Globalization and disproportionate growth of world trade is also affecting our lives and transforming the world.

Cypriot business men and women should not think and behave in the narrow confines of the home market. A stroll in a supermarket will help us understand and appreciate this simple truth. Your competitor is not anymore your neighbour but somebody may be a thousand miles away. Every Cypriot business man if he wants to survive economically has to think globally and not within the narrow geographical borders of his country.

European banks will need to grow out of their national boundaries if they are to compete with the likes of Chinese and American banks. Consider that in the U.S. and China there is one Central Bank and one set of rules while in the EU 27. In Cyprus with a total population of around 1 million we have two. Local National banks will be limited to retail banking and regulation will need to be centralized far more than it is today in the Eurozone.

This is why if changes are not carried out in the next decade global corporate banking will be concentrated in the hands of the Chinese and American banks.

The centre of world trade and economic activity at the time when Christ was born was in Asia. In the 15th century it started moving to the West and by the end of the Second World War the centre of world trade and economic activity was the United States. However, the centre of the world is once again moving back to Asia, to China and India. The emerging economies are currently undergoing their industrial and urban revolutions that today's developed countries had started in the 19th century.

Demographics: People are living longer and fertility is declining.

In a recent study I saw some alarming figures. In 1950 in the developed countries only 8% of the population was over the age of 65, by 2000 this percentage increased to 14% and according to forecasts it will reach 21% of the population in 2025 and 26% in 2050. At the same time fertility is declining rapidly and as a

result the number of people of working age is continuously decreasing.

Caring for large numbers of old people will create new demands for employers from developing countries (Consider that only in Cyprus we have tens of thousands of employees from developing countries taking care of older people). All these create new demands on government finances.

As a result national insurance schemes that were devised 30 or 50 years ago are not anymore relevant.

Changes in Interactions

All these changes lead to interactions between the various activities that we had not thought of and cannot clearly visualize.

For example in about ten years a large proportion of cars will not be driven by humans but computers in some central locations. The number of accidents will decline significantly but at the same time the demand for artificial organs will increase. Everything is correlated and as you can see driverless cars can lead to fewer accidents but at the same time lead to shortage of transplants and ultimately a large increase in the demand for artificial human organs.

I could go on talking for hours about changes that are taking place all the time around us. We need to point out however that as a rule, the way people behave and accept change is much slower than the speed of change.

There is no doubt that there is a powerful human tendency to want the future to look much like the past, and here is the irony of the situation. As citizens of this World, as members of the European Union, Greek Cypriots recognize that to survive and compete in the modern world they have to change and adapt to the worldwide trends. But thinking politically they behave as if nothing has changed in Cyprus in the last 50 years. However, in reality too much has changed and unless we are able to adapt to the new conditions, we will pay the price.

The world is changing on many levels and at a fast pace. This is only going to accelerate. If you remain burdened by a political problem of occupation and division and all the uncertainties this entails, you will stay behind and this will

only be to the detriment of all the people of Cyprus. Cyprus cannot remain divided in two; we have to do our utmost to achieve the best possible solution not only for ourselves but mainly for our children and grandchildren.