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Amor Fati? Europe Wounded after the Cyprus Imbroglio

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For the past two weeks, we have been witnessing a fierce diplomatic game with Cyprus at the epicenter of a geopolitical vortex threatening European solidarity. The Cyprus case offered the ideal testing ground on which some of the key players of the European economic crisis stretched their muscles and tried out new ideas such as the bailing-in of uninsured depositors – not an option before the Cypriot crisis. At the same time, Nicosia and by default the debtor countries of the European South got a flavor of their limited diplomatic clout and a hard to miss warning about what may lie ahead if things get worse. Is this another crisis Europe can muddle through? Or does it inaugurate an era of dangerous instability due to irreconcilable interests between the Eurozone's 'haves' and 'have-nots' in the absence of political skills to mitigate its consequences?

The debacle over the debt-ridden island is emblematic not only of the growing dysfunctionalities of the monetary union but of the unchallenged hegemony Germany exercises over Europe. It is widely argued that the small size of the island's economy and likely limited contagion risk prompted the German leadership to use Cyprus as a laboratory case for future bail-outs. Arguably, the tepid reaction of the markets following the rejection of the first bail-out plan by the Cypriot Parliament persuaded Mr. Schäuble that a Cy-exit could set a positive precedent and send a clear message to the rest of southern countries struggling to meet Berlin's stern budgetary standards. The German leaders' popularity is suffering a heavy toll across the European South but they find this less costly than trying to convince German voters that their hard-earned money is going to shore up fundamentally rotten countries or bail-out wealthy Russian oligarchs. In the meantime, the real victim of the German hard line is the Eurozone itself and the prospects of a banking union. Even if the intentions of the German leadership is to prepare the ground by deleveraging inflated banking sectors, attacking the sanctity of bank deposits and causing anxiety among its Southern peers is no way to go about it. It is not yet clear if there is a German plan for hegemonising Europe or whether Germany is building an accidental Empire through its protestant obsession with punishing Southern profligacy. What is less uncertain is that Germany's unchecked hubris is more likely to reap resentment and suspicion; especially given the widespread certainty among citizens of the debtor countries that Germany is profiting from the crisis by way of interest payments and capital inflows from a devastated European periphery doomed to sluggish growth for many years to come.

Cyprus, on the other hand, has had to pay a huge price for its oversized banking sector and failing fiscal policies. While there can be some sympathy for the island's decision to stake its economic development on financial services given that all its physical inputs are imported, no kudos can be offered to its leadership's gambling strategy. Cypriot politicians committed a litany of errors. From failing to take the necessary measures when the island lost access to international markets almost two years ago, to agreeing on a raid on insured depositors and misjudging the intentions of the Russians. The alleged shock from the restructuring of Greek government debt (to which Cypriot domestic banks were heavily exposed) is not enough reason to absolve the Cypriot politicians and especially the Christofias government from failing to prevent the disproportional capital expansion of the Cypriot banks and the country's fiscal derailment. Blaming Greece had become the favorite pastime of the Cypriot political elite in the same way that in Greece the Troika has become the scapegoat of a discouraged political establishment suffering from reform fatigue. But this is not to exonerate myopic European policies. The Eurogroup could have avoided the shock therapy by recapitalising the bloated Cypriot banks through the European Stability Mechanism and gradually purging them of laundered Russian money. But the message is clear to all. The days that banks and countries were bailed out from tax payers' money is over. Instead, a hierarchy of creditors is proposed to absorb bank losses and the future no longer looks quite so rosy, perhaps not even for insured depositors in Europe's brave new world.

Cypriot leaders were even slower in reading Russian motives. The Cyprus bailout has effectively ended Cyprus's stint as a Russian tax haven even while holding much Russian assets frozen via capital controls. Cyprus spared no bargaining chip to attract Russian assistance: from offering privileged access to offshore gas deposits, to promising a warm-water port for the Tartus based Russian fleet. Although the Cypriot levy badly injured Russia's image abroad and was openly condemned by Medvedev as theft, President Putin had few reasons to seek a serious confrontation over Cyprus with the EU, Russia's largest trading partner. The promise of offshore gas deposits is still too uncertain and Cyprus geopolitical entanglement with Turkey is a headache the Russians would like to avoid. Furthermore, in his State of the Union address in December last year, Putin called for the 'de-offshorisation' of the Russian economy. He played the diplomatic game of vocally protecting Russian depositors but when the time came he shirked from bailing out offshore accounts of a Putinist oligarchy whose loyalty is unquestioned. Yet, the danger of a geopolitical accident, as Prime Minister Medvedev called it, cannot be excluded.

The Cypriot government may have been surprised to discover that the geopolitical fault-lines in the region are more complex than it had imagined but the fact that an EU country felt more at ease approaching an outsider than resolving the crisis internally is telling of a growing solidarity deficit among EU members. The Cyprus crisis has put a strain on long-established traditions of consensus-building in EU consultations. More importantly, the crisis has brought forth real antagonisms over wealth inequalities in the Eurozone that can no longer be swept under the carpet. On the contrary, they may further stiffen positions as addressing them entails major redistribution of resources and skillful statesmanship that an erratic European elite seems unable to deliver.

Does all this look familiar? Is Europe going down a power politics path similar to that which locked the European nations in intransigent positions and inflexible alliances just before the outbreak of the First World War? Cyprus might not be Sarajevo nor trigger something as dramatic as war. But the growing polarisation between the European north and south would be no less catastrophic if it signalled the collapse of the European integrative experiment and the return of long-forgotten animosities. All Europeans would do well to pay heed to the words of former Euro Group chairman Jean-Claude Juncker: "Anyone who believes that the eternal issue of war and peace in Europe has been permanently laid to rest could be making a monumental error. The demons haven't been banished; they are merely sleeping."

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