

# **The Cyprus Adjustment Programme – Necessity or Wrong Medicine**

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## ***Abstract***

This paper attempts to evaluate whether the Cyprus adjustment program signed with the Troika was a necessary precondition to correct the imbalances in the economy in 2013. Although the factors leading to these imbalances appeared to be of exogenous nature, it is argued that the underlying problems were homegrown. In 2008, the Cyprus economy presented a satisfactory picture. However a careful assessment would have brought to the surface the hidden structural imbalances, which led in the subsequent years, to an unsustainable bubble. These home grown imbalances were not addressed, in contrast adjustment was delayed and the negotiations with Troika took an unduly long time to conclude, with severe consequences. Against this background, the implementation of the adjustment programme of Cyprus is considered as successful. However, given the rather low growth prospects further reforms are required. In the current debate, there is some support for utilizing the perceived fiscal room to stimulate the economy. However, it is argued that the case for adopting an expansionary fiscal stance is not strong given the still high level of public debt. Some elements of MOU are highly controversial. The most prominent one was the bail-in of uninsured depositors. This paper argues that, instead of imposing upfront losses to the uninsured depositors, a long-term adjustment path in the banking sector would have been preferable, because it would have allowed the economy to adjust in a smoother manner without damaging the confidence in the banking sector. At the end of the paper the issue of political ownership of the reform program is raised.

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