

Cyprus rejects bailout plan that would make savers pay, raising anxiety in euro zone



By Michael Birnbaum and Howard Schneider

BERLIN — Lawmakers in Cyprus on Tuesday rejected a bailout plan that would have rescued the country's banks but forced savers to chip in for the cost, throwing down a gauntlet to the rest of Europe over the financial fate of the tiny island nation.

The plan to save Cyprus's collapsing banks but to charge depositors for the service proved so controversial that not one of the 56 members of Cyprus's parliament voted for it Tuesday evening. The rejection leaves the fate of rescue plans up in the air, with other European leaders

so far unwilling to step in to save Cyprus, where bank deposits tower over the rest of the economy.

Parliamentarians “feel and they think that it’s unjust,” Cypriot President Nicos Anastasiades told reporters Tuesday.

The rejection leaves Cyprus, the International Monetary Fund and the rest of Europe in a standoff familiar from previous bailout negotiations, with the country trying to navigate its local politics and possibly get a better deal for itself as the others stand firm on how much they want to commit to yet another troubled euro-zone nation.

The fate of the 17-nation currency union, meanwhile, again hangs in the balance, threatened by a country that constitutes just 0.2 percent of the zone’s collective economy. Throughout the crisis, European policymakers have tried to keep any country from leaving the euro. Losing a member nation would pose uncertain risks to the world financial system and be politically embarrassing to the major powers such as Germany and France that designed the currency union.

Overall, Cyprus needs about \$20 billion — an amount equal to its annual economic output and a sum that, if all borrowed, would throw the country’s finances onto unsustainable footing. The IMF’s internal rules do not allow the fund to make loans to the country under those circumstances. Euro-zone countries are hesitant to lend the full amount, as well.

As a consequence, the fund, the euro zone and the European Central Bank want to cap the amount of international loans to Cyprus at about \$12.5 billion and leave the country to come up with the rest. The deposit tax was one alternative for raising the money. It had the advantage of grabbing \$2.2 billion to \$3 billion from foreigners, many of them Russian, who own more than one-third of the money on deposit in Cypriot banks.

In a sign of the severity of the situation, Britain on Tuesday dispatched a military plane loaded with a million euros to Cyprus “as a contingency measure” for soldiers stationed at British bases in the Mediterranean country, in case they are not able not access their savings in Cypriot banks, according to a British Defense Ministry spokesman.

Other options could exact more from local families and businesses through government spending cuts or taxes, even if they avoid the direct hit on savings accounts. Euro-zone countries could also relent and lend more, though that would be politically sticky at home.

The IMF did not have any immediate comment on the Cyprus vote. IMF managing director Christine Lagarde has endorsed the existing proposal as one that “appropriately allocates” the costs of the country’s financial rescue.

The plan rejected Tuesday would have left deposits under \$26,000 unscathed, foisted a one-time 6.75 percent tax on deposits between \$26,000 and \$129,000, and taxed deposits above that at 9.9 percent.

The latest turmoil is a potent reminder of the fragility of the financial situation in Europe, where troubles at its periphery have threatened for the past three years to spread to some of its largest economies.

Cypriots have been lining up to take cash out of automated tellers as fast as the machines can be loaded, and a Monday bank holiday was extended through the end of Wednesday to prevent a broader run on deposits.

Anastasiades's office said he would speak to German Chancellor Angela Merkel by phone Tuesday to update her on the situation in his country. The pair also spoke Monday. Anastasiades planned to hold an emergency meeting of Cypriot political leaders Wednesday morning to discuss what to do next.

Wealthy Russians have long flocked to Cyprus as an offshore banking haven, and many European officials suspect it is a hub for money laundering, a conclusion reached in a report by Germany's foreign intelligence service that has circulated widely in Berlin.

The plan that was rejected would have forced Cyprus to abandon its guarantees on deposits of up to \$130,000, a stunning new precedent in Europe's three-year-long economic crisis. Many analysts and officials said Cyprus should have simply honored those guarantees and concentrated the burden on larger deposits. But Cyprus has been loath to imperil its status as a financial center. Cypriot Finance Minister Michalis Sarris flew to Moscow on Tuesday afternoon to talk with furious Russian leaders about the implications for their citizens' deposits.

"They needed to make a trade-off between having any future as a financial center and appearing to be fair and progressive to their own citizens," said Sony Kapoor, the managing director of Re-Define, a Brussels-based think tank. "I think they possibly made the wrong decision there. And that has poisoned the air."

In rejecting the rescue plan, Cypriot lawmakers appeared to be gambling that European governments would soften their stance. But in Germany, whose Parliament must approve any bailout, lawmakers of all stripes were lining up Tuesday to oppose any concessions. Their resolve may have been bolstered by markets, which were down only modestly Tuesday despite the unease. The euro dropped 0.5 percent against the dollar, to \$1.289.
