The Republic of Cyprus needs to find new money - fast. The real bill for Cyprus's debts could spiral as high as 15billion Euros. The Republic's government wants to avoid the notorious EU/IMF austerity package. Moscow's huge reserves of foreign capital can easily prop up the Cypriot economy and develop a substitute base in Cyprus at the same time. At some point the EU's minnow state could find itself effectively swallowed up by two geo-strategic sharks

By John Hughes-Wilson

The Republic of Cyprus is the latest EU country to find itself running out of hard cash, thanks to being in the Eurozone. This is embarrassing, to say the least. The Republic took over the rotating presidency of the EU at the same time as it urgently needs billions of euros to rescue Cyprus's troubled banking sector, owed billions by bankrupt Greece.

Unsurprisingly, Cyprus's banks are closely linked with the Greek economy. So, when Greece ran out of cash, so did the heavily exposed Cypriot banks who had bought now worthless Greek bonds and loaned Greeks money.

However, the true cost in the future could be much worse. If Greece were to be forced leave the Eurozone, the real bill for Cyprus's debts could spiral as high as 20 billion Euros; a huge sum for a tiny country with an total annual budget of only 17 billion euros. The consequences of a Greek exit from the Eurozone would be catastrophic for the Republic.

But, at the moment, Cyprus' real problem is short term: very short term. To avoid the spectacle of the presidency of the European Union as a bankrupt, begging country, the country is negotiating hard to find new money. Because it's money that the small country of less than a million people just doesn't have.

Now that its credit rating has been reduced to junk status, Cyprus is unable to borrow from international markets. Instead, it has been relying on a €2.5 billion low-interest loan from Russia just to see it through to the end of this year and to pay its government's wage bills.

Cyprus needs an extra 5 billion euros (with other debts equivalent to a whopping 23 percent of its GDP) just to bail out the Cyprus Popular Bank, the island's second-largest lender, and the most exposed to Greek debt. It has to boost the bank's capital levels to an EU target but there's no spare cash in the vaults.

And the problem is going to get worse: official estimates place Cyprus's true new money requirements, whether Greece defaults or not, at 15 billion euros at least over the next two years.

Cyprus approached the European Union's EFSF rescue fund and asked for a bailout, like the

unfortunate Greeks themselves. As a Eurozone member since 2008, Cyprus is eligible for EU money; and Cyprus's cash needs are a fleabite to a Eurozone already committed to bailing out Spain alone for at least 548 billion euros over the next few years. However, Cyprus, up till now, has been strangely reluctant to seek EU assistance.

Because, fortunately for Nicosia, Cyprus differs from bankrupt Spain, Greece, Ireland and Portugal, in having two options. Unlike the other blighted countries on the Eurozone's periphery, Cyprus can look beyond the European Union for financial assistance.

The Nicosia government has an ace up its sleeve. As well as any potential European Union bailout, it can negotiate yet another Russian loan. There is every sign that this will be the course Nicosia will choose.

The Cypriot government has made it quite clear it fears that any EU bailout would have unpalatable strings attached and would force Nicosia into making painful budget cuts as a condition for getting the money. In particular, Nicosia is afraid that it might be asked by its EU partners to 'harmonise' (ie, increase) its low 10 percent corporate tax rate, which attracts much foreign business.

The Republic's government also wants to avoid the notorious EU/IMF austerity package, whose rigorous conditions have brought the Greek, Portuguese and Irish economies to their knees. With only Russian visitors keeping tourism going, the economy in the South is bad enough already without any help from Frankfurt or Brussels.

And Nicosia knows that being forced by the European Central Bank and the IMF to make budget cuts, delay pensions, cut public services and lay off government workers, just seven months before next February's elections is political suicide. Attempts to cut back on social benefits in the South have already sparked widespread strikes and protests.

All the signs are that Nicosia is planning to rely on Moscow for additional help.

The Kremlin has many reasons for wanting to help Nicosia and strengthen Russia's position in the Eastern Mediterranean. Cyprus is not a member of NATO. The Island's strategic position off the Levantine shores, its traditional opposition to Turkey's strategic power in the region and the island's potential hydrocarbon resources all offer considerable benefits to the Kremlin.

With Syria falling apart, Russia's only naval base in the Mediterranean at Tarsus on the Syrian coast is now at risk. The Kremlin needs to seek alternative Mediterranean ports for its Black Sea Fleet. Cyprus is the obvious place. Moscow's huge reserves of foreign capital can easily prop up the Cypriot economy and develop a substitute base in Cyprus at the same time.

In the circumstances, Moscow can afford to be generous and offer much better loan terms than Cyprus's Eurozone partners. Moreover, Russia already has a staunch agent at the heart of Nicosia's politics.

President Demetris Christofias, old style Communist, fluent Russian speaker from his Moscow

university days, and friend of the Kremlin, with his crypto-communist party AKEL, see Russia as a trusted ally and a partner with vested interests in the island's economy. Over the years Russians have salted away literally billions of roubles into Cypriot banks, many of them from highly dubious sources. Converted into Euros, a lot of this money has found its way back to Moscow to be reinvested in Russia's growing economy. This happy exchange has also funded Russian companies, eager to invest in natural gas exploration, now that a bonanza of hydrocarbon deposits have been discovered off Cyprus' south coast. Russia has strong incentives to help cash-strapped Cyprus.

And, to make things even better, such Russian support does not prevent Cyprus' application for aid from the European bailout fund. In fact, having another loan actually strengthens Cyprus' hand in negotiating better terms for any Eurozone bailout from its EU partners.

Cyprus could now be in a very strong position. EU bailout money would recapitalize its broken banks: and Moscow's money would allow Cyprus to keep control of its own budget, finance the country's debt and keep the economy going until the oil and gas starts to pump money into Nicosia's coffers. There is however two complications: Cyprus is already deeply in hock to Russia, whose presence in the South is now all pervasive. It would be an enormous embarrassment, both to the EU, NATO and many Greek Cypriots to discover that Cyprus's long term future is with Moscow, not the West.

Cyprus' second problem is Israel. Tel Aviv is openly competing with the Kremlin to be Cyprus's new 'best friend', drawn by greed for the gas deposits and looking for strategic 'basing facilities' astride what is Israel's main supply route. While the Republic is keen to put Cyprus's position as a mere offshoot of the Eurozone's most bankrupt member behind them by building alliances with both Israel and Russia, it could end in tears.

Although Christofias and the ambitious politicians in Nicosia clearly believe that an oil-rich Cyprus will soon become a big player in the region, and even hope that one day - with Israeli and Russian backing, naturally – to be able to stand up to Turkey, geo-politics has always been a dangerous game. At some point the EU's minnow state could find itself effectively swallowed up the competing geo-strategic sharks of Moscow and Tel Aviv.

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