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Small debt, large problems in Cyprus: How even small debt in a British Colony led to the political crisis and violence in October 1931.

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Abstract:

During the interwar period Cyprus faced a small deficit, yet the inflexibility of the colonial finance structure created a political impasse. As a result the disagreements between the Colonial government and the Cypriot elected members of the islands legislative assembly sparked violence against the regime. Such violence would not have been possible if the already aggrieved political and economic situation allowed those with nationalistic agenda to undermine the legitimacy of the colonial regime. Although the traditional argument indicates that the 1931 riots were a purely nationalistic act, the disagreements of the colonial government and the actions of the leaders of the largest communities have to be understood within the sense of increasing crisis caused by the continual fall GDP. At the same time, the political situation was paralysed to react in a severe economic depression in part due to the disagreements between the Governor and the colonial office in London on one hand and the internal struggles for control within the Turkish and Greek communities. As a result the tinder for the violence in 1931 may have been nationalistic, but the fuel was provided by the prolonged economic crisis in Cyprus.

The economic crisis influenced the political stagnation, reduced the ability of government to react and created a sense of imminent crisis that could only be averted through drastic action. Some commonalities may be seen with current events in Cyprus, especially in how government resists a structural reduction of government revenue just when public opinion and economic orthodoxy (of the time) seemed to suggest it.

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Current Situation in Cyprus:

On Tuesday the 4th of December 2012, the president of Cyprus, Demetris Christofias, announced on television that Cyprus will be signing a memorandum to borrow 17 billion euros from the collective colloquially known as “Troika” (comprising of the representatives of the European Central Bank (ECB), the European Commission (EC), and the International Monetary Fund (IMF)²). The European Commission estimates that the Cypriot government deficit will reach 5.3% of GDP in 2012, and deep cuts to the 2013 budget are expected. Despite the fact that interest groups (government officials, government monopolies, educators) have warned of repercussions if the agreement is implemented, there has not been substantial protest movement against the proposed austerity measures, which are supported by all the political parties.

Was it inevitable for Cyprus to ask for a bailout in 2012? There is no doubt that the close economic interaction with Greece, especially in the banking industry led to the destabilisation of the Cypriot banking system. The increase of loan defaults in Greece, combined with the haircut in government bonds, led the two largest banks (with total assets larger than the GDP of Cyprus³) to ask for a yet unspecified amount of government support (subject to independent audit). Due to the need to price assets as a “mark to market” the needs of the banking system (including the cooperative sector) to meet the tier 1 capital requirement of 9% are expected to be close to 10bn euro. However, the government would have faced the need for a bailout without the banking issues due to the combination of the increasing deficits and the need to roll over expired debt. A full 6bn is needed just for government rollover of debt, as this government chose to just borrow short term (2 to 3 years maturity) over the last four years, and as a result it is facing close to 80% of the current debt maturing in 2012/2013. An additional 1bn is needed for the government budget deficit, which has been breaking the government own estimates since taking office.

Since the start of the global financial crisis there have been persistent calls by opposition parties, business organizations and the governor of the Central Bank of Cyprus for a reconsideration of the government expenditures in order to reduce the government deficits, only to be ignored by the government, which chose to increase the deficit. When the Cypriot government found itself facing prohibitive interest rates in the world markets it chose to borrow a substantial amount of its debt short term, only to have a very large proportion due for repayment in 2012. The

² The memorandum of understanding between the Troika and the government of Cyprus has been leaked to the press: <http://www.politis-news.com/upload/20121130/1354292326-07337.pdf> as accessed 05/12/2012

³ Total assets of the banking system was 896% of Gross Domestic Product or GDP in 2010. Source: Stephanou, Constantinos, “The Banking System in Cyprus: Time to Rethink the Business Model?” *Cyprus Economic Policy Review*, Vol. 5, No. 2, pp. 123-130 (2011) 1450-4561.

combination of the bank bailout, the debt rollover and the large deficit will result to the debt to GDP of Cyprus will rocket from 48.6%⁴ in 2008 over 150% in 2012.

The response to the current crisis:

This crisis seems to have convinced policymakers at a European level that the answer is more regulation for the Eurozone. By joining the monetary union, Eurozone countries, like Cyprus, effectively surrendered monetary policy to the European Central Bank, as well as committing to fiscal policy restraints (through the Stability and Growth pact). There seems to be a belief in European stakeholders that problems faced by Portugal, Greece, Cyprus, Spain and Italy arise due to insufficient control over fiscal matters on an EU level despite the growth and stability pact of the Eurozone such arrangements. It seems that the concerns of the Euro's structure was highlighted by academics prior to the crisis⁵. Such concerns are leading the current European response to the crisis: the need to have further fiscal integration and coordinated banking control. However, the new measures, described below, have led to substantial disagreement from academia as not really correcting the main weakness of the Euro's structure⁶.

The current Eurozone crisis has led to sustained attempts to change the infrastructure of the monetary union, without leading to the collective responsibility for government debts of nation states. New agreements such as the "Six pack" measures of additional fiscal surveillance, the Macroeconomic Imbalance Procedure and the May 2012 "Treaty on Stability, Coordination and Governance", as well as the recent agreement for common banking supervisory arrangements seem to point out that the EU policy makes see as the main issue that they need to tackle is how to eliminate moral hazard for national governments, committing them to restructuring their national economies rather postponing decisions through borrowing.

With the exception of the unified banking supervision programme, the above changes seek to severely restrain the ability of nation states to dictate an autonomous fiscal policy if a fiscal deficit ensues. The above is supposed to encourage fiscal stability within the Eurozone, allowing Eurozone countries to be better prepared and capable to withstand future global economic crises without the need of external aid.

Will the current Eurozone changes provide the ability to whether global downturns for nation states? A case study from 1930's Cyprus

⁴ IMF, "Country Report Cyprus", *World Economic Outlook 2012* (IMF, 2012) <http://www.imf.org/external/pubs/ft/weo/2012/01/weodata/index.aspx> as accessed 09/11/2012

⁵ Sims, Christopher A., "The Precarious Fiscal Foundations of EMU" *De Economist*, Volume 147, Number 4 (1999), 415-436

⁶ As the situation is fluid and recent, opinions of experts are better seen in sites such as CEPR's www.oxeu.org, where substantial disagreement to the agreed policies

Why is the past relevant to the current situation? Cyprus (and Malta), who are current members of the Eurozone, are former British colonies. The proposed changes to the Eurozone (with the exception the new unified banking supervision) partially echo past colonial arrangements. Colonial Cyprus was under strict monetary control through a currency control board, where the monetary supply was linked to the amount of sterling deposits in London⁷. Additionally, colonial governors would be under pressure from London if the colony's administration failed to be financially self-sufficient⁸. Borrowing from the private London money market was encouraged for infrastructure projects, but only if the colony could repay itself and if the British government was not forced to step in and service the loan. Hence there was no collective guarantee of colonial loans between Britain and Cyprus.

Despite being part of the British Empire, Cyprus was originally not a colony per se, but a possession granted in 1878 which could be given back to the Ottoman Empire. As a result, despite having no substantial debt, it was facing an issue that echoed the need of debt service of a state today. The occupation of Cyprus in 1878 came with a provision that stated that the yearly amount of tax £92,799 pounds sterling would be given to the Ottoman Empire in lieu of lost tax revenue. Although such a large amount was not extracted by the Porte from Cyprus, the colonial office in London demanded it raised by the colony⁹. Thus the mandates of the British administrators of Cyprus focused in raising government revenue through maintaining the Ottoman taxation system rather than making institutional changes that might jeopardise the creation of a surplus to pay the amount required¹⁰. The amount debited to the colony ranged from 40% to 55% (depending on the agricultural season) of the government's revenue, and with the exception of the years 1892 and 1893 the colonial office had to ask for a grant in aid ranging between £15,000 to £55,000 to cover the shortfall. After insistent protests that the yearly request for aid disturbed planning, the 'tribute' assistance fixed as a permanent grant-in-aid of £50,000 in 1907; yet £42,799 of the 'tribute' remained a burden to government expenditure until 1927, when it was abolished for a £10,000 annual contribution to imperial defence¹¹. By 1927, the island's colonial status was also on a secure footing after it was annexed by Britain in 1914 and made a crown colony in 1925.

In summary, Cyprus significantly reduced the fiscal pressures of servicing the "tribute" on the government budget prior to the great depression by an effective reduction of the external

⁷ Phylaktis, K. *The Banking System of Cyprus: Past, Present and Future*, (London: Macmillan, 1995), p.42

⁸ Hodge, J.M., *Triumph of the Expert-Agrarian Doctrines of Development and the Legacies of British Colonialism*, (Athens: Ohio University Press, 2007) p.13

⁹ Although this amount was not a tribute but a payment of forgone tax revenues, it was labelled erroneously by the press as the 'Turkish Tribute'.

¹⁰ Georghallides, *Cyprus and the Governorship...*(1985) p.181; The British administration raised most of the 'tribute' from taxation in Cyprus, but the Ottoman government did not receive it as the British Treasury used the money to pay interest (but not the principal) to the shareholders of the defaulted 1855 Ottoman loan, which was guaranteed by Britain.

¹¹ Georghallides. *A Political...* (1979) p.36; Georghallides, *Cyprus and the Governorship...*(1985) p.57

servicing by £32,799. In 1927 government revenue was £705,996, thus indicating a reduction of 4.6%, a significant but not an overwhelming improvement.

It is worth noting that there was a reduction in the debt service burden for the republic in Cyprus upon joining the Eurozone in 2008. The risk premium of government bond yields fell, freeing up funds from the government expenditure side¹².

How did the Colonial government react to this windfall gain?

During the interwar period there was a movement for change within the colonial office: some members believed in encouraging governors to initiate positive development measures, with an aim to forge the empire into a more prosperous and concrete whole¹³. The appointment of Leo Amery as secretary of state for the colonies strengthened the hand of these ‘new imperialists’¹⁴. However, there was substantial resistance to such views within the colonial bureaucracy: as a result colonial officers who wanted more active development measures were not always successful, especially if such measures would involve additional British expenditure and thus necessitating approval from the British treasury. However, Amery sometimes succeeded in placing those who shared this point of view in key posts and he was instrumental in appointing Sir Ronald Storrs, as governor of Cyprus in 1926¹⁵.

Sir Ronald Storrs was an ambitious man who at the age of 45 had already served as Oriental Secretary in Cairo and Military Governor of Jerusalem. He had influence in circles that previous High Commissioners of Cyprus did not have access to. Storrs arrived in Cyprus facing an unusual situation. The declaration of the island as a crown colony removed any legal claim to the raising of the “Tribute” – the amount of £92,799 previously mentioned. He played an instrumental part towards the removal of the above payment and its replacement by a £10,000 fee for imperial defence and hence deserves the credit for the existence of this windfall, even though he kept secret part of the agreement waiving the right of the colony to the accumulated balances of the tribute.

Sir Ronald Storrs believed that an increase in economic prosperity would alleviate the increasing nationalistic pressures of the majority Greek Cypriots for union with Greece¹⁶. Such demands

¹² The fall was between 1 and 2% on the yield of 5 year and 10 year bonds, while the gap between 5 year and 10 year bonds narrowed. Source: Central Bank of Cyprus, Money banking and other Financial Statistics 1993-2007 http://www.centralbank.gov.cy/nqcontent.cfm?a_11573 (as accessed 5th Dec 2012)

¹³ Georghallides, *Cyprus and the Governorship...* (1985) p.118

¹⁴ Hodge, *Triumph of the Expert* (2007) p.7, p.14, p.114; Oxford Dictionary of National Biography: L.S. Amery. http://www.oxforddnb.com/view/article/30401?_fromAuth=1 as consulted 21 Oct 2008. Amery expressed his views clearly and extensively in: Amery, L.S., *My Political Life: Volume 2* (London, Hutchinson, 1953) p.52

¹⁵ Georghallides, *Cyprus and the Governorship...* (1985) p.5

¹⁶ Storrs, R., *Orientalisms* (London, Ivor Nicholson and Watson, 1945)

were given a new impetus by the offer of Cyprus to Greece during the First World War, the return of Cypriot volunteers in the Greek army and Woodrow Wilson's call for self-determination.

Storrs devised a strategy to increase the standard of living based on the fiscal windfall, with the ultimate aim of reducing nationalistic sentiment. Focusing on increasing the role of government in terms of healthcare, education and infrastructure, Storrs increased both the wage and size of the bureaucracy in order to be able to attract experts in Cyprus, putting them to work on the longstanding issues of rural debt, irrigation, and healthcare. Despite the original desire that the windfall gain would be used as repayment for a development loan (supported by the elected members of the legislative council), the colonial government found the windfall used up by government expenditure and hence unavailable for infrastructure loan amortisation. As the windfall was quickly used up in expanding government expenditure no effort to revamp the tax system away from import duties and agriculture taxation took place: in fact in an effort to increase revenue, specific taxation such as the "prevention of locust tax" was diverted to other uses.

As a result government revenue and expenditure expanded dramatically, despite the lacklustre growth of GDP (see table 1). The per capita growth of income was substantially less than the growth of government expenditure in each full year Storrs was Governor (his appointment was announced in August 1926). In fact with an average growth of GDP of 0.9%, the annual growth of government revenue was 10.3%. The colonial government under Storrs increased the importance of the colonial government in the Cypriot economy, with government expenditure rising from 11.1% of GDP in 1926 to 16.1% in 1931. It is true that Cyprus still had a very small share of government in 1931, but the share of government was increasing rapidly at a time when the economy of Cyprus was struggling.

What is interesting is that the governorship of Sir Ronald Storrs begins with a volatile yet rapidly increasing income, but still the increase of expenditure and revenue of the government was far in above the growth of the economy even prior to the great depression.

Table 1A: Cypriot GDP, Population, Per capita GDP, Government Revenue and Expenditure in constant 1938 Cyprus pounds¹⁷

| Year | GDP | Population | Per capita GDP | Government Revenue | Government Expenditure | Budget Deficit / Surplus | Year | GDP | Population | Per capita GDP | Government Revenue | Government Expenditure | Budget Deficit/ Surplus |
|------|------------|------------|----------------|--------------------|------------------------|--------------------------|------|-----------|------------|----------------|--------------------|------------------------|-------------------------|
| 1921 | £3,732,544 | 310,715 | £12.01 | £418,112 | £415,599 | £2,513 | 1930 | 4,911,844 | 344,042 | £14.28 | £677,372 | £747,559 | £-70,187 |
| 1922 | £4,001,854 | 314,253 | £12.73 | £471,461 | £393,196 | £78,265 | 1931 | 4,605,234 | 347,959 | £13.23 | £727,766 | £742,164 | £-14,397 |
| 1923 | £4,125,691 | 317,830 | £12.98 | £424,504 | £435,959 | £-11,455 | 1932 | 4,213,399 | 353,982 | £11.90 | £761,123 | £748,050 | £13,073 |
| 1924 | £4,029,952 | 321,449 | £12.54 | £435,785 | £393,591 | £42,194 | 1933 | 4,232,438 | 360,109 | £11.75 | £748,102 | £698,357 | £49,745 |
| 1925 | £4,342,975 | 325,109 | £13.36 | £489,381 | £453,850 | £35,531 | 1934 | 4,755,859 | 366,342 | £12.98 | £776,723 | £722,396 | £54,327 |
| 1926 | £4,169,484 | 328,810 | £12.68 | £444,797 | £463,148 | £-18,351 | 1935 | 5,318,422 | 372,683 | £14.27 | £899,557 | £853,725 | £45,832 |
| 1927 | £4,678,897 | 332,554 | £14.07 | £455,657 | £427,200 | £28,456 | 1936 | 5,237,377 | 379,134 | £13.81 | £824,552 | £760,560 | £63,992 |
| 1928 | £4,574,781 | 336,340 | £13.60 | £507,504 | £483,490 | £24,014 | 1937 | 6,226,713 | 385,697 | £16.14 | £956,656 | £835,170 | £121,487 |
| 1929 | £5,189,706 | 340,169 | £15.26 | £637,223 | £602,063 | £35,160 | 1938 | 6,544,460 | 392,373 | £16.68 | £1,023,230 | £908,024 | £115,206 |

Table 1B: Growth rate of Cypriot GDP, Per capita GDP, Government Revenue and Expenditure

| Year | GDP | Per capita GDP | Government Revenue | Government Expenditure | Year | GDP | Per capita GDP | Government Revenue | Government Expenditure |
|-----------|-------|----------------|--------------------|------------------------|-----------|-------|----------------|--------------------|------------------------|
| 1921-1922 | 7.2% | 6.0% | 12.8% | -5.4% | 1930-1931 | -6.2% | -7.3% | 7.4% | -0.7% |
| 1922-1923 | 3.1% | 1.9% | -10.0% | 10.9% | 1931-1932 | -8.5% | -10.1% | 4.6% | 0.8% |
| 1923-1924 | -2.3% | -3.4% | 2.7% | -9.7% | 1932-1933 | 0.5% | -1.3% | -1.7% | -6.6% |
| 1924-1925 | 7.8% | 6.6% | 12.3% | 15.3% | 1933-1934 | 12.4% | 10.5% | 3.8% | 3.4% |
| 1925-1926 | -4.0% | -5.1% | -9.1% | 2.0% | 1934-1935 | 11.8% | 9.9% | 15.8% | 18.2% |
| 1926-1927 | 12.2% | 11.0% | 2.4% | -7.8% | 1935-1936 | -1.5% | -3.2% | -8.3% | -10.9% |
| 1927-1928 | -2.2% | -3.3% | 11.4% | 13.2% | 1936-1937 | 18.9% | 16.9% | 16.0% | 9.8% |
| 1928-1929 | 13.4% | 12.2% | 25.6% | 24.5% | 1937-1938 | 5.1% | 3.3% | 7.0% | 8.7% |
| 1929-1930 | -5.4% | -6.4% | 6.3% | 24.2% | 1926-1931 | 2.0% | 0.9% | 10.3% | 9.9% |

Note: Deflated using the CPI provided in appendix H of Apostolides, A. (2010) Source: Cyprus, *Statistical (Blue) Books*, (1921-1938) "Government Revenue and Expenditure"

¹⁷ Apostolides, A. (2010) "Economic Growth or Continuing Stagnation? Estimating the GDP of Cyprus and Malta, 1921-1938", *London School of Economics Theses*,

Table 2A: Cypriot GDP, Population, Per capita GDP, Government Revenue and Expenditure 1997-2014 (projected) ¹⁸

| Year | GDP constant prices | Population | Per capita GDP | Government Revenue | Government Expenditure | Budget Deficit / Surplus | Year | GDP | Population | Per capita GDP | Government Revenue | Government Expenditure | Budget Deficit/ Surplus |
|-------|---------------------|------------|----------------|--------------------|------------------------|--------------------------|-------------------|---------|------------|----------------|--------------------|------------------------|-------------------------|
| Unit | Bn Euro | Thousands | Euro | Bn Euro | Bn Euro | Million Euro | Unit | Bn Euro | Bn Euro | Thousands | Bn Euro | Bn Euro | Million Euro |
| 1997 | 9,895 | 673 | 14,701 | 2,448 | 2,845 | -397 | 2006 | 13,955 | 758 | 18,413 | 6,069 | 6,244 | -175 |
| 1998 | 10,391 | 682 | 15,234 | 2,776 | 3,130 | -354 | 2007 | 14,666 | 776 | 18,890 | 7,126 | 6,570 | 556 |
| 1999 | 10,893 | 690 | 15,791 | 2,967 | 3,365 | -398 | 2008 ⁺ | 15,192 | 797 | 19,064 | 7,389 | 7,228 | 161 |
| 2000 | 11,439 | 697 | 16,400 | 3,455 | 3,689 | -234 | 2009 | 14,910 | 819 | 18,203 | 6,764 | 7,794 | -1,031 |
| 2001 | 11,900 | 706 | 16,867 | 3,830 | 4,071 | -242 | 2010 | 15,081 | 840 | 17,957 | 7,213 | 8,139 | -926 |
| 2002 | 12,153 | 714 | 17,028 | 3,943 | 4,435 | -492 | 2011 | 15,153 | 862 | 17,579 | 7,282 | 8,401 | -1,119 |
| 2003 | 12,380 | 723 | 17,125 | 4,428 | 5,192 | -764 | 2012 ^P | 14,812 | 876 | 16,912 | 7,510 | 8,359 | -848 |
| 2004* | 12,904 | 733 | 17,602 | 4,828 | 5,347 | -520 | 2013 ^P | 14,670 | 890 | 16,490 | 7,315 | 8,318 | -1,003 |
| 2005 | 13,402 | 744 | 18,013 | 5,535 | 5,869 | -334 | 2014 ^P | 14,770 | 904 | 16,346 | 7,408 | 8,557 | -1,149 |

Table 2B: Growth rates of Cypriot GDP, Per capita GDP, Government Revenue and Expenditure

| Year | GDP | Per capita GDP | Revenue | Expenditure | Year | GDP | Per capita GDP | Revenue | Expenditure |
|-----------|------|----------------|---------|-------------|------------------------|-------|----------------|---------|-------------|
| 1997-1998 | 5.0% | 3.6% | 13.4% | 10.0% | 2006-2007 | 5.1% | 2.6% | 17.4% | 5.2% |
| 1998-1999 | 4.8% | 3.7% | 6.9% | 7.5% | 2007-2008 | 3.6% | 0.9% | 3.7% | 10.0% |
| 1999-2000 | 5.0% | 3.9% | 16.4% | 9.6% | 2008-2009 | -1.9% | -4.5% | -8.5% | 7.8% |
| 2000-2001 | 4.0% | 2.8% | 10.9% | 10.4% | 2009-2010 | 1.1% | -1.4% | 6.6% | 4.4% |
| 2001-2002 | 2.1% | 1.0% | 3.0% | 8.9% | 2010-2011 | 0.5% | -2.1% | 1.0% | 3.2% |
| 2002-2003 | 1.9% | 0.6% | 12.3% | 17.1% | 2011-2012 | -2.3% | -3.8% | 3.1% | -0.5% |
| 2003-2004 | 4.2% | 2.8% | 9.0% | 3.0% | 2012-2013 | -1.0% | -2.5% | -2.6% | -0.5% |
| 2004-2005 | 3.9% | 2.3% | 14.6% | 9.8% | 2013-2014 | 0.7% | -0.9% | 1.3% | 2.9% |
| 2005-2006 | 4.1% | 2.2% | 9.6% | 6.4% | 2008-2012 ^C | -0.6% | -3.0% | 0.4% | 3.7% |

Note: *Joined the European Union. ⁺ Joined the Eurozone ^PProjected ^CDemetris Christofias time in office

¹⁸ IMF, *World Economic Outlook Database* (October 2012 release) <http://www.imf.org/external/pubs/ft/weo/2012/02/weodata/index.aspx> as accessed 06 Dec 2012

What was occurring in Cyprus during the period prior to the current economic crisis? The following table gives some clues. The revenue and expenditure of the Cyprus government once again outstripped output growth and likewise, government expenditure kept rising even after it became clear that 2010 was a year of severe recession.

It is worth noting that the presidency of Demetris Christfias began with a decline of per capita GDP which we would call severe (-4.5% in 2008-2009). As a result of the way taxes were collected the decline in revenue was -8.5% while revenues increased by 7.8% causing a jump in the borrowing needs of the government for which the government has not been able to recover.

The general economic dimension is not here in order to compare two recessions (as they have different methodologies: the older series is deflated to constant prices making even government expenditure and revenue more volatile) but to indicate that despite being different crises, the governments faced similar dilemmas: as GDP slowed down, governments faced the dilemma of reducing the growth rate of expenditure in the name of fiscal prudence or tax/borrow.

The Great Depression and its impact on Cyprus: Credit Crunch

Since 1921 was a year of severe recession in Cyprus, the per capita GDP indicates that recovery was slow in the 1920s. Like other areas of Europe, the agricultural sector was already suffering a severe debt and credit crisis through a reduction of prices from their First World War peak¹⁹. The deflationary effects resulted to rural borrowers being unable to repay the rural debt incurred during the war as they extended cultivation, since the real cost of repayment rocketed²⁰. Thus the additional deflation during the great depression resulted to a dramatic increase in the real cost of debt service. This reduction of the price of crops made private debt service of farm debt impossible²¹. The debt of rural producers was the most important issue in the Cypriot press and the problem remained unresolved until the start of the Second World War²².

¹⁹ Like most colonies in the war the increase of production was though extending cultivation but no productivity improvement. Rothermund, D., *The Global Impact of the Great Depression 1929-1933* (New York: Routledge, 1996) pp.39-40; Federico, G., "Not guilty? Agriculture in the 1920s and the Great Depression", *The Journal of Economic History*, Vol.65, No.4, (December 2005) p.956

²⁰ Federico, G., "Not guilty?" (2005) p. 951

²¹ Fischer, Irving "The debt deflation theory of Great Depressions" *Econometrica* Vol.1 No. 4 (1933) pp.337-357, Lanitis, N. C., *Rural Indebtedness and Agricultural Co-operation in Cyprus (Revised edition)*, (Limassol: Proodos Printing and Publishing Ltd, 1944; revised 1992), p.18, pp.22-23

²² Lanitis, *Rural Indebtedness...* (1944; revised 1992) p.15 The colonial government tried to support farmers without by passing laws placing a ceiling on the rate of interest. However, usury laws only led to the formalization of the debts and through mortgaging of land.

Table 3: Price Indexes of Cypriot products, selected years (1938=100)

| | CPI | Carobs | Potatoes | Wine | Cotton | Wheat (Wholesale) | Wheat (Retail) | Goats | Cheese |
|------|-----|--------|----------|------|--------|----------------------|-------------------|-------|--------|
| 1912 | - | 90 | 88 | 305 | 130 | 148 | 90 | 300 | 108 |
| 1916 | - | 106 | 210 | 534 | 129 | 322 | 230 | 290 | 92 |
| 1919 | - | 133 | 250 | 763 | 292 | 329 | 360 | 350 | 157 |
| 1922 | 142 | 91 | 186 | 275 | 158 | 159 | 160 | 200 | 254 |
| 1923 | 134 | 81 | 158 | 175 | 206 | 130 | 110 | 110 | 185 |
| 1926 | 142 | 93 | 142 | 175 | 164 | 216 | 180 | 150 | 195 |
| 1927 | 144 | 95 | 156 | 175 | 163 | 197 | 180 | 200 | 185 |
| 1929 | 141 | 135 | 150 | 138 | 197 | 202 | 140 | 225 | 179 |
| 1930 | 119 | 64 | 106 | 125 | 123 | 140 | 130 | 175 | 154 |
| 1931 | 107 | 45 | 138 | 125 | 103 | 117 | 110 | 100 | 159 |
| 1932 | 106 | 65 | 107 | 125 | 22 | 106 | 100 | 100 | 133 |
| 1938 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |

Source: CPI- Apostolides, A. (2010) "Economic Growth or Continuing Stagnation? Estimating the GDP of Cyprus and Malta, 1921-1938", *London School of Economics Theses*, Appendix; Rest - Cyprus, *Statistical (Blue) Books*, (1911-1938).

The deflation during the great depression affected land prices in a severe way; the decline of prices realised at sale relative to the debt being recovered indicates that land was worth much less than when the said mortgage contract was made. According to available Land Registry Office data in table 4, the debts were increasing during the period and so were the incidences of forced sales of property, forcing the government to restrict forced sales in 1933 and 1934²³.

Table 3: Loans, Debts and Forced Sales 1921-1938

| | Total Value of Mortgages | Share of Mortgages to GDP | Total Value of Property | Number of forced sales | Price realised at sale / debt sought to be recovered |
|------|-----------------------------|------------------------------|----------------------------|---------------------------|---|
| 1921 | N/A | N/A | N/A | 1.416 | 74% |
| 1922 | N/A | N/A | N/A | 2.386 | 66% |
| 1923 | N/A | N/A | N/A | 2470 | 57% |
| 1924 | N/A | N/A | N/A | 3.304 | 59% |
| 1925 | N/A | N/A | N/A | 3.108 | 60% |
| 1926 | N/A | N/A | N/A | 2.916 | 56% |
| 1927 | £1,647,810 | 24% | £14,200,000 | 2405 | 61% |
| 1928 | £1,644,574 | 26% | £15,500,000 | 1639 | 57% |
| 1929 | £1,782,452 | 29% | £15,520,886 | 1559 | 58% |
| 1930 | £1,949,320 | 37% | £15,634,975 | 1444 | 55% |
| 1931 | £2,005,051 | 41% | £15,748,761 | 1795 | 57% |
| 1932 | N/A | N/A | N/A | 1150 | 51% |
| 1933 | £2,212,548 | 51% | N/A | 134 | 69% |
| 1934 | £2,299,842 | 49% | £16,308,464 | 387 | 69% |
| 1935 | £2,269,675 | 44% | £16,717,008 | 1508 | 57% |
| 1936 | £2,290,980 | 44% | £16,529,383 | 2067 | 54% |
| 1937 | £2,203,175 | 35% | £16,673,889 | 1999 | 51% |
| 1938 | £2,207,896 | 34% | £16,862,739 | 1491 | 53% |

Source: Georghallides, (1979) p.429, Cyprus, *Annual Report of the Land Registry Department*, (1921-1938).

²³ Cyprus, *Annual Report of the Land Registry Department 1934*, (Cyprus, GPO, 1935) p.4

The severe decline in GDP and the increase in rural debt default would not have been as severe if the global economic downturn did not coincide with a severe drought. The Cypriot economy faced two exogenous blows outside its control: the global great depression occurred at the same time as one of the deepest and most prolonged droughts on record. The drought hit the rural majority in 1930 when they were already under pressure by the decline of prices of their products and the increase of the real cost of repayment, while at the same time being asked by the government to contribute more through increasing taxation.

Rainfall in Cyprus was always erratic, but consecutively bad years are unusual events. In 1930 rainfall was slightly lower than average, yet the seasons 1931-32 and 1932-1933, rainfall was much lower than 70% of the average (defined as a major drought event), while the rains in 1933-1934 were just between 71%-80%²⁴. This has a big impact to a colony which produced 30% of its GDP from agriculture in 1929: the majority of production was rain-fed or rain-capture, with less than 21% of agricultural production having access to other water sources²⁵. The drought was so severe that even industries not directly to water suffered serious losses. Animals were culled due to the lack of adequate fodder and there was even a reduction of land with access to irrigation to just 15% of the cultivated land in 1931.

Thus, as global agricultural prices were declining, the yield of Cypriot agricultural products collapsed due to the lack of sufficient aquifers²⁶. The combined decline in output and prices led to a collapse in the value of output; this especially affected grain farmers of the Mesaoria plain around Nicosia, who were completely dependent on rainfall. The result was that rural incomes were squeezed both by a decline in agricultural production and by a precipitous fall of prices, dramatically effecting rural incomes. The demands of the government for greater taxation squeezed the majority rural population still further.

It is important to remember that for the farmer, the decline in incomes was greater than the decline of GDP indicates, since the decline here is in constant prices, thus taking into account only the decline in quantities and not prices. It is not easy to be as accurate in current prices due to the lack of substantial price data, but using the constructed CPI as a single deflator indicates that the fall of income in current prices in 1933 when compared to 1929 was 30%.

²⁴ Source: Meteorological Service of Cyprus, *To Κλίμα της Κύπρου* [The Climate of Cyprus], http://www.moa.gov.cy/moa/ms/ms.nsf/dmlcycclimate_gr/dmlcycclimate_gr?opendocument&print as consulted 23 Jan 2008.

²⁵ Source: Apostolides, A. Economic Growth or Continuing Stagnation? Estimating the GDP of Cyprus and Malta, 1921-1938. (Phd thesis, London School of Economics, 2010)

²⁶ Global price fall: Grilli, E. & Maw, C.Y., "Primary Commodity Prices, Manufactured Goods Prices and the Terms of Trade of Developing countries: What the Long Run Shows", *World Bank Economic Review*, Vol.2, (1988) pp.1-47

Table 4: Selected indexes of production 1929-1933 (1929=100)

| | Value of imports | Value of exports | GDP | Total Agriculture, Forestry and Fishing | Mining and Quarrying | Annual Crops | Growing of Perennial Crops | Animal products | Growing of Vegetables | Growing of oleaginous crops | Growing of cereals |
|---------------------------|------------------|------------------|------|---|----------------------|--------------|----------------------------|-----------------|-----------------------|-----------------------------|--------------------|
| 1929 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |
| 1930 | 72 | 72 | 95 | 99 | 65 | 90 | 114 | 99 | 81 | 14 | 87 |
| 1931 | 71 | 62 | 89 | 88 | 52 | 70 | 105 | 102 | 80 | 135 | 65 |
| 1932 | 68 | 54 | 81 | 80 | 42 | 48 | 86 | 100 | 68 | 12 | 44 |
| 1933 | 63 | 51 | 82 | 74 | 58 | 60 | 67 | 94 | 59 | 17 | 62 |
| 1934 | 72 | 64 | 92 | 89 | 61 | 83 | 90 | 91 | 68 | 70 | 85 |
| Cumulative Fall 1929-1933 | -37 | -49 | -18% | -26% | -42% | -40% | -33% | -6% | -41% | -83 | -38% |
| Share of GDP in 1929 | 38% | 30% | 100% | 31% | 8% | 12% | 8% | 7% | 2% | 1% | 8% |

Source: Apostolides, A. Economic Growth or Continuing Stagnation? Estimating the GDP of Cyprus and Malta, 1921-1938. (Phd thesis, London School of Economics, 2010)

The decline of the agricultural sector dragged the income of affiliated industries downwards. The combination of decline in agricultural prices, the great drought and the reduction of migration opportunities (that increased the growth of population) meant that the per capita recovery was slow. And yet government expenditures kept increasing, despite the colony not having the automatic stabilisers of increased social insurance expenditure.

The insistence of the government to increase taxes while incomes were being squeezed created pressure to the political actors who were elected by their communities, the delegates of the Legislative Council. As government was continually demanding an increase in taxation, the council members requested an intervention of the government to alleviate the issues affecting the rural majority.

Perhaps presciently for the current situation, the decline of income during the great depression created a credit crunch and a crippling of the informal credit system: the transition mechanisms were price deflation and the decline in land prices. The current need for a bailout of the major banking institutions might have been initiated by poor foreign investments but the decline in prices has been a mechanism of transition, once again reducing the amount of credit significantly.

Government Response in the great depression: “Business as Usual”

How did the colonial government respond to the complex problems caused by the great depression? The governor attempted a “Business as Usual” approach of increasing taxation and maintaining the expansion of the government. It must be said that the decision to go ahead like it was “Business as Usual” was common colonial government response in Cyprus. But

such approach stored problems that needed to be dealt with further down the road. An example was the existing tax system during the great depression in Cyprus. The taxation system was largely based on farming taxes and import/export duties; property tax was a very small share of revenue and income tax was not levied²⁷. Taxation in Cyprus was particularly regressive as it relied heavily on the taxing staples such as petrol, flour, sugar, salt and tobacco as well as the taxation of pigs, trees²⁸. Despite the complicated and inefficient tax system, and the fact that 66% of the government revenue was related to the import and export of commodities in 1927, there was no willingness to restructure it²⁹. Thus despite Oakden describing the tax rate of Cyprus as modest, he did concede that a disproportional amount was extracted from two sectors which are the most cyclical sectors of the economy: Trade and Agriculture³⁰.

During the great depression, the reduction in trade was much more severe than the reduction of income. As a result the colonial government found its revenue targets continuously missed. Storrs government constantly increased taxation with additional laws, with eleven tax increases in six year. These increases needed the approval of the Legislative Council.

The existence of the council meant that the acceptance of the tax increase was in theory not guaranteed. The legislative council was granted early in the British reign in Cyprus and provided for government officials and representatives of the two largest religions in Cyprus, Christian (the majority; overwhelmingly Greek) and Moslem (the minority, overwhelmingly Turkish). The community leaders were elected. Elections were open to anyone who paid the very modest property taxes and hence a large proportion of the male population was eligible to vote³¹. The council could only vote to approve or reject laws and appropriation budgets sent by the government: the government did not have to listen to the opinion of its members or accept laws suggested.

In practise the council was a formality due to the use of political patronage. From the beginning the council was based on the policy of *divide et impera*, as the Greek Cypriots (henceforth G/C) could always be outvoted by the combination of the Turkish Cypriot (henceforth T/C) councillors and the members of the administration. As the government had substantial patronage over the T/C community through their control of EVKAF religious foundation, the elected officials of the T/C community was largely in favour of the government line³².

²⁷ There were some capita taxes on animals as well as some taxes on property and capital (Defter Hakani and Vergi Kimat), but these taxes did not contribute significant amounts to the total government revenue. Until 1925 a tithe on agricultural products was also in place, replaced by additional taxes on imports.

²⁸ Oakden, *Report on the Finances* (1935) pp.45-46; Cyprus, *Report... System of Taxation in Cyprus* (1930) p.6

²⁹ Source: Cyprus, *Statistical (Blue) Books*, (1927).

³⁰ Oakden, *Report on the Finances* (1935), p.56

³¹ Georghallides, *A Political...*, (1979), p.42.

³² For example, Ifran Bay was a member of the executive and the legislative council, as well as the Turkish delegate of the EVCAF which administered Muslim religious property and charity. Thus his ability to exert substantial patronage over the Turkish-Cypriot community depended on maintaining the favour of the colonial administration.

However, during the great depression, this *divide et impera* policy broke down in the face of increasing economic distress and perceived government indifference. The control of the legislative council was premised on the fact that the minority T/C members would vote with the government representatives and thus overrule the majority G/C delegates. Yet from 1930 onwards, the divide and rule system was cracking, as elections brought delegates willing to vote in ways that would defeat the government in economic issues, despite being very against the nationalist agenda of the other community.

The 1930 elections for the council saw the community moderates being largely defeated and the new, more nationalist councillors willing to resist the demands of the government take their place. The electoral losses were mainly a backlash by voters to moderate councillors willing to cooperate with the colonial government. On the other hand the councillors felt they were being responsible for their electorate but powerless, since “so much power was given to foreigners while keeping the Cypriots in positions of great weakness”³³. For example, even in the cases when the elected members of the council would combine and defeat a bill, the Cypriot constitution provided for the ability to enact the bill anyway through an Order-in-council by the British monarch.

As additional taxation was needed to maintain the current government expansion, Sir Ronald Storrs called on the legislative council. The government insisted in an expansionist revenue policy, demanding and being granted additional taxation increases by the council in the period 1929-1931. He was upbeat about the economic conditions on the island, and suggested further increases in taxation in order to protect the Cyprus Agricultural Bank and irrigation projects of the Mesaoria plain. Storrs maintained that his government initiated more development projects than previous administrators: the ‘tribute’ was abolished, an agricultural bank was established, the co-operative movement was expanded; thus he felt that Cyprus was progressing economically on the basis of his reforms and continued to believe that 1931 would have been a good year for mining, which would have increased the tax receipts through royalties. As a result, Storrs felt that there was no need to reduce expenditure despite the depression affecting the farming community. Storrs optimism was proven unfounded: yet even in 1931 when the dual calamity of the great depression was obvious, Storrs, in his address to the Legislative council, saw no reason for reduced optimism or change of course³⁴.

See: Holland, R. & Markides D., *The British and the Hellenes: Struggles for Mastery in the Eastern Mediterranean 1850-1960*, (Oxford: Oxford University Press, 2008), Chapter 6

³³ Clerides, *Ελευθερία*, 6 Dec 1922, 23 Dec 1922

³⁴ Georghallides, *Cyprus and the Governorship...*(1985) p.544

In fact the mining industry was facing a meltdown. The large Amiantos mine closed due to severe financial pressures, while the largest employer in the island, the Cyprus Mines Corporation, suspended production in its largest mine³⁵.

The fact that the Cyprus government in the period 1930-1931 found itself projecting overoptimistic revenue made controlling for the emerging budget deficits very difficult, effectively exhausting the limited reserve of the colony. As the reserve was exhausted the government was forced to keep asking for more taxation increases from the Legislative council. The council was becoming increasingly militant against the combined demand for revenue and their belief of the lack of government attention to the needs of the farming sector.

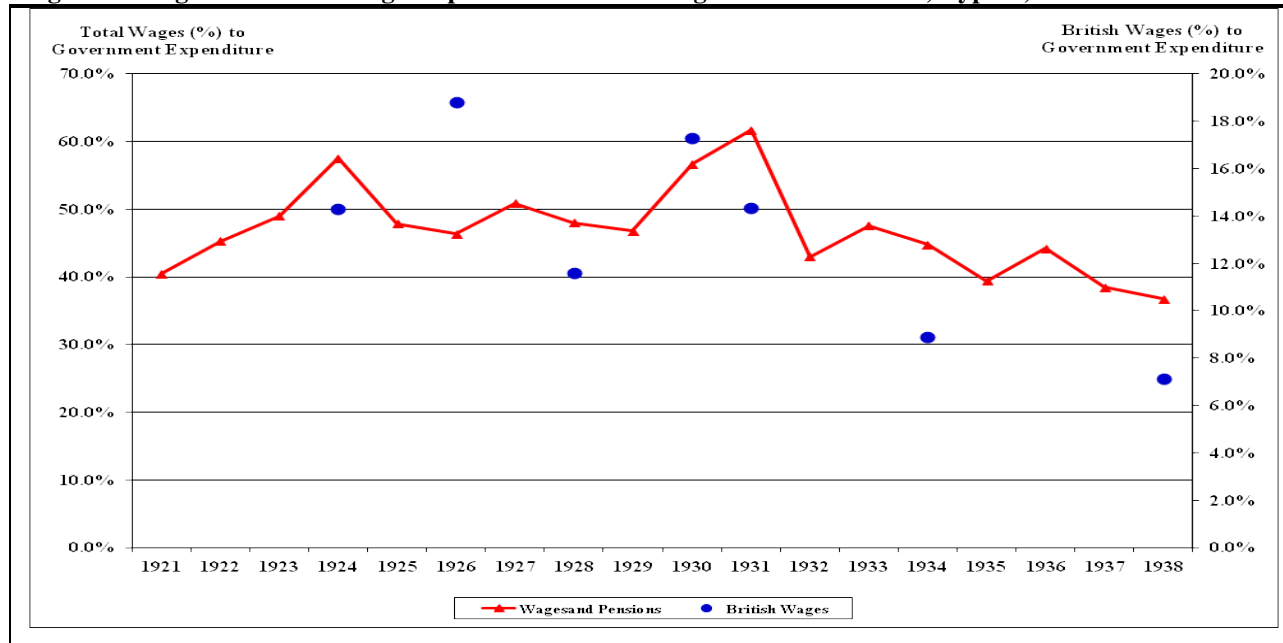
The G/C legislative council deputies, led by the Bishop of Kition, the Metropolitan Nicodemos Mylonas, suggested in the discussion for the 1932 appropriations bill that under his calculations a deficit of £100,000 would arise in the 1931 appropriation bill, which the island could not cover with its remaining reserves. As there was no colonial lender of last resort, the Metropolitan worried that further tax increases would be needed in 1932, and instead suggested for a decline of government expenditure by £70,000.

The reduction in expenditure requested by the government was effectively nationalistic in character: it called for a general reduction in government wage bill, but especially for the higher paid British members of staff. Arguing that Cypriots could do the job better and cheaper, and noting the fact that the share of British citizens wages to total government expenditure was high and rising, this was seen as a way to increase demands for self-determination (voiced by G/C politicians) by replacing expensive British officials with competent Cypriots.

Figure 1 indicates that the Cypriot legislative councillors were right to worry that the government would cut non-wage expenditure by more than wage expenditure in an effort to balance its budget during the depression, their official reasoning for a reduction in the wage bill of the highest earners. During the depression the share of wages to total government expenditure peaked at 61.7% as the government cut down other spending and focused on paying wages. A substantial amount of that wage expenditure was being received by three dozen British bureaucrats to the resentment of the legislative council. In 1930 these employees absorbed more than 17% of the total government expenditure, as their wage remuneration was compared to UK rates rather than local rates of pay. Thus while projects such as the construction of an experimental farm and irrigation schemes were being scrapped, Cypriot councillors were incensed that wages of such officials were not substantially reduced in order to limit the budget deficit.

³⁵ Apostolides, Alexander (2012): *Copper and Foreign Investment: The development of the mining industry in Cyprus during the great depression*. Proceedings of the Biennial International Conference of Greek Studies, Flinders University, 2013.

Figure 1: Wage and British Wage* expenditure as share of government revenue, Cyprus, 1921-1938.



Note: * British wages calculated by selecting the highest salaried officials and removing those whose last name suggested Turkish, Greek, Armenian or Maronite descent. Source: Cyprus, *Statistical (Blue) Books*, (1921-1938).

Nicodemos Mylonas tried to convince all of the G/C elected members at least one of T/C delegates to reject the government taxation bills in order to have the law thrown out. His attempt to reach common ground was not popular by some G/C and T/C delegates. Nikodemos calculated that staying away from nationalistic issues and focusing in immediate farming alleviation measures and tax increase resistance had a greater chance of receiving bi-communal support³⁶.

For the Metropolitan to suggest an alternative plan is a bold overstepping of the council's power: it was a direct overstepping of the remit of the council, which stated it could accept or reject laws, but not suggest policy. The colonial officials would not and did not accept the right of the council to suggest laws, and instead avoided the need for council approval through their use of "orders-in-council": laws were passed directly in London through a order by the King in session.

The consequence: even a small deficit can have serious political consequences

The militancy of the council made Storrs reluctant to ask the legislative council for the additional increase in taxation, certain that it would be defeated³⁷. Thus despite the fact that "orders-in-

³⁶ The Bishop of Kition, the Metropolitan Nikodemos Mylonas, was a member of the legislative assembly from 1925 until his forced deportation to exile in 1931. He was a very astute economic commentator, having substantial education in Paris and Athens, and was responsible for the establishment of the first historical journal in Cyprus.

³⁷ Sir Ronald Storrs as quoted in Georghallides, *Cyprus and the Governorship...*(1985) p.453

council” were for extreme events in relation to the crown, such orders were ever more frequently used to circumvent the resistance within the legislative council. Yet late in 1931 the relationship between the colonial government in Cyprus and the colonial office in London broke down.

The loss of the majority of the colonial reserve fund in 1931 led to the colonial office of London pushing to revise his optimistic revenue figures downwards³⁸. The reluctant Storrs would need to once again go to the council to demand more taxation for the proposed budgetary expenditure of 1932³⁹. The objective in forcing Storrs into more realistic targets was due to the fact it was not willing to act as a lender of last resort: It needed to make sure that the UK taxpayer would not have to pay for a shortfall of the colonial government budget in Cyprus. When the demand for more revenue was rejected in the council, there was a delay in London in passing the bill through an “order in council”, as they sought to ensure that Storrs did cut expenditure enough to ensure the budget would balance.

At this moment it is important to emphasise that within the G/C and T/C communities the dismal economic situation created frictions in the political relationships within the communities. Throughout the interwar period, the Greek-Cypriot leadership was divided in how to promote their demand of union with Greece (*Enosis*)⁴⁰. Moderates, such as Nikodemos Mylonas were willing to work with the colonial government in order to develop the island, hoping to convince the British that Cypriots could be trusted with self-government. They saw the dual-government constitution given to Malta in 1921 as a possible reward for continued cooperation⁴¹. The moderates believed that after achieving self-government Britain might be convinced to cede Cyprus to Greece, as it did previously when it ceded the Ionian Islands protectorate in 1864, and when it aided Cretan *Enosis* in 1913⁴².

Extremists argued that cooperation perpetuated the British occupation of Cyprus. They argued that only union with Greece would solve all the economic and social problems of the island, since Cypriots would be cared for by a government who had their national interests at heart. For them *Enosis* was the only goal that subjugated others, and a policy of resistance against colonial rule was gaining support as the economic situation deteriorated. Many had fought for the Greek state during Balkan wars and the First World War, and upon their return to Cyprus they had demanded the launching of a struggle to expedite union with Greece⁴³. The decision made in

³⁸ Georghallides, *Cyprus and the Governorship*....(1985) p.563

³⁹ National Archives, London. File: CO 67/236/11 “Estimates 1931”, Note by W. Shipway 21 Dec 1930; Georghallides, *Cyprus and the Governorship*....(1985) p.457, p.544

⁴⁰ The chief institution that promoted the cause of the Greek-Cypriot majority was the autocephalous Orthodox Church of Cyprus: but even senior church leaders were divided between moderates and extremists.

⁴¹ Clerides, *Ελευθερία*, 13 Jan 1922. Author’s translation from Greek.

⁴² For the Ionian Islands see: Holland, & Markides, *The British and the Hellenes* (2008) Chapter. 3

⁴³ An example: Lanitis Nikolaos of Kleathis, a legislative council member who made impassioned speeches for *Enosis* in the council, was a volunteer in the Greek army during the Balkan wars; in 1931 he was deported for his political beliefs.

1923 by the G/C leadership to cooperate with the colonial government was not accepted by all, and extremist sections attacked the councillors in the press thought the great depression, arguing that they would not be able to achieve anything other than to legitimise British rule, since the colonial government was not interested in the prosperity of the island⁴⁴.

The worsening economic situation brought things to a heated and dangerous impasse both within the government and Cypriot elected representatives, but also within the communities themselves. The role of traditional communal leaders was being challenged by new more radical members, who were ennobled by the feeling that something needed to be done to help the distressed rural community.

The result was that a consensus against government plans emerged during the period 1920-1931. Greek and Turkish councillors showed signs in indirect cooperation, thus breaking the power of “divide and rule” over the council. Speeches by members of both communities, even by moderates were exasperated by situation, and asked for the government to listen to their demands in terms of economic planning. Although still uncoordinated, the legislators of Greek and Turkish origin began to more forcefully demand in 1930 for: greater intervention of the state in agriculture, an increase in protectionism (including imperial products), and a substantial reduction of the government wage bill⁴⁵.

The government’s relative inaction towards the farming crisis led to the appearance of rifts in its close relationship with the Turkish-Cypriot councillors. The councillor Dr. Eyoub voted regularly against tax increases, arguing that the government should first check its rising expenditure, especially in terms of civil service salaries. As the economic situation deteriorated, the Turkish-Cypriot councillors were under pressure to vote for increased taxation that would further reduce the income of their community. The weakness of the administrations’ finances increased the power of the legislative council to demand its opinions to be heard, but the circumvention of the council altogether through Orders-in-council increased the frustration of political leaders who were already under pressure for the willingness to cooperate with the colonial authorities. The disagreement between the council and the government led to a political friction that could ignite to violence.

By April 1931, the government was forced to pass further tax increases through “orders-in-council”, after acrimonious debates in the legislative council ended in the bills being constantly defeated in the Legislative council through the combination of Greek and Turkish Cypriot delegates. As the drought was prolonged, Nicosia was inundated by grain farmers from the surrounding Mesaoria plain, who had lost their livelihood. Their presence made the political

⁴⁴ Ibid.

⁴⁵ Georghallides, *Cyprus and the Governorship...*(1985), pp.154-157, p.567

deadlock potentially explosive and Cypriot councillors felt the pressure that something had to be done to help farmers immediately.

The government's continued use of orders-in-council led to increasing calls by the Greek-Cypriot radicals for the Greek-Cypriot legislative councillors to resign and begin a policy of open resistance for union with Greece⁴⁶. The growing pressure by the press eliminated any room for manoeuvre of important Greek-Cypriot leaders, such as the Metropolitan Mylonas, who were afraid of losing leadership of the Greek-Cypriot community. The leadership of the Greek Cypriot community was being challenged, threatening the role of the church as the interlocutor of the community's desires. Faced with such an upheaval within their own ranks, Greek-Cypriot leaders, such as the previously moderate Metropolitan Mylonas, chose to declare an open call for civil disobedience since "As a member of the council ... taken the oath of Allegiance to King George, but as a ecclesiastical and national leader I am now obliged to recommend to the Cypriots... [to] disobedience" for the goal of union with Greece⁴⁷.

The governor was shocked: the moderate Bishop had openly called for civil disobedience and questioned the legitimacy of the British rule, on the basis of it failing to deliver the promised economic welfare to the population. Storrs did not expect this: even at the end of his life the governor refused to believe that the Bishop wrote the manifesto of his resignation⁴⁸. Yet the colonial administration failed to understand the pressure brought to bear by the communities who elected them councillors such as Nicodemos to the council. Faced with the massive reduction of per capita incomes and the partial failure of the agricultural crop, community leaders had to deliver something to their communities. The decision to ignore the councils suggestions on economic planning and to use orders in order to raise taxes on staple imports made the moderates positions untenable. The Bishop of Kition felt that unless he acted the church would lose the primacy as the main organ of expression of the community's desires.

The announcement of the Bishops' registration letter led to a protest march in Nicosia that concluded in violence and the burning of the Governor's house: from then on riots spread throughout the island, leading to several deaths⁴⁹. We were able to account for 153 incidents of disturbances, and we have placed 146 on the map of Cyprus using GIS software. Figure 2 shows the incidents of disturbances as overlaid over the main agricultural crop of each area. Excluding the incidents in cities, over 62.6% of disturbances occurred in areas that were mainly growing wheat, which had the most significant drop in output due to the combination of the drought and the Great Depression.

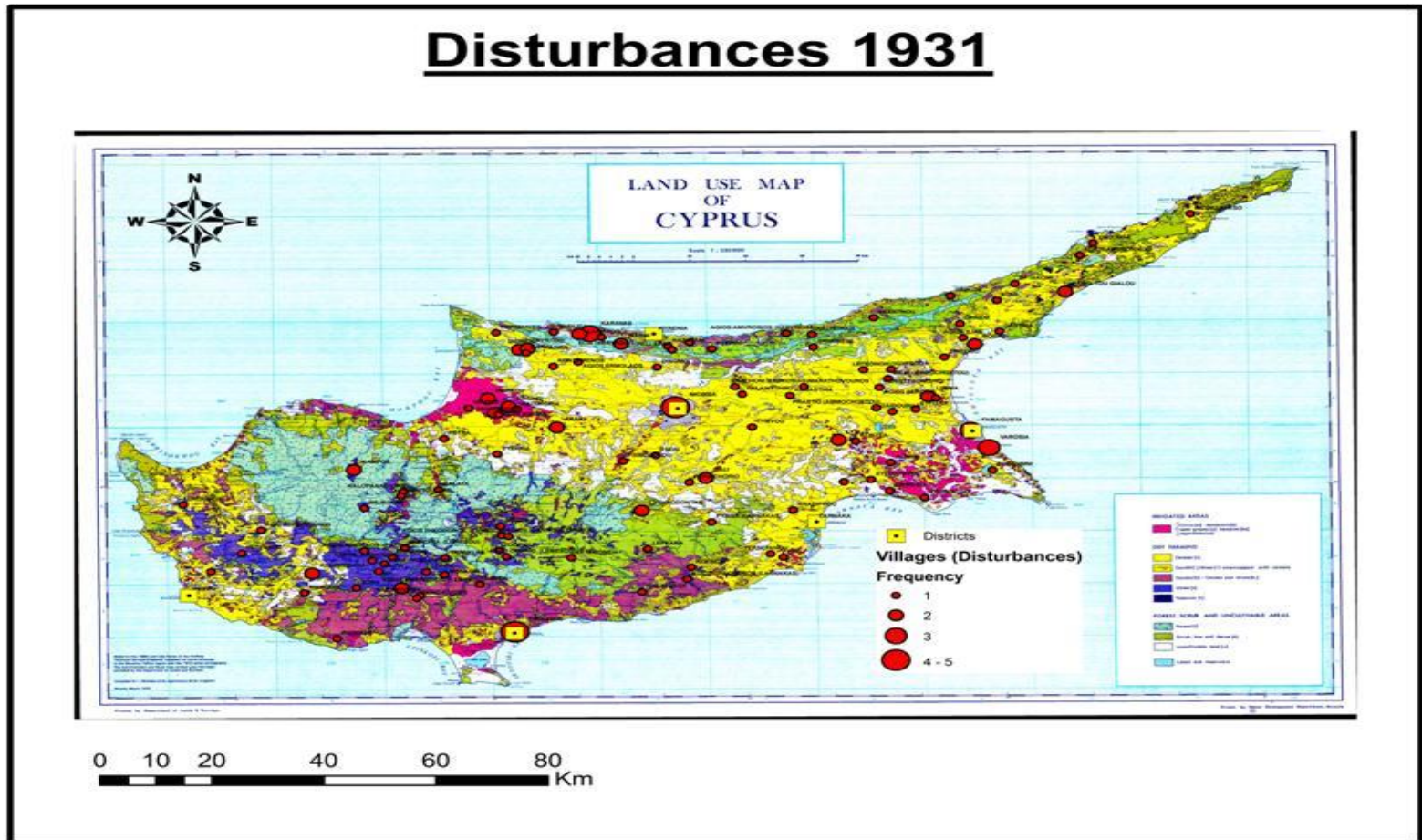
⁴⁶Theodotou, T. *Ελευθερία* 23 March 1929 ; Georghallides, *Cyprus and the Governorship...*(1985) p.7

⁴⁷ A full transcript of his resignation speech: Georghallides, *Cyprus and the Governorship...*(1985) pp.688-690

⁴⁸ Storrs, R., (1945) *Orientalisms* p.506

⁴⁹ Command 4045, "Disturbances in Cyprus in October 1931" (1931) p.541

Figure 2: GIS of Disturbances in October 1931



The riots were widespread and significant, lasting for over a month and taking place in every district of the island. The riots resulted in 21 dead Cypriots (the British confirm only 17) and an unknown number of wounded. Military re-enforcements were rapidly flown in, leading to the quelling of the unrest by the end of October. Storrs reputation did not survive the riots: he was replaced by a military governor. The military governor decided to cover the the budget deficit of 1931 and 1932 through a punitive tax against the Greek-Cypriot population as the instigators of the violence, a tax which was collected until 1936. The colonial government resinded the council and it remained authoritarian until independence in 1959: the main actors, including the Bishop of Kition was sent in exile, and over 2,679 persons were convicted in connection to the riots.

The basis of the disagreement between the legislative council was effectively not so much about whether a deficit was in order, but about which preventative actions were needed to avoid the a deficit occurring in 1921. The fact is it was very clear that London was not willing to act as a lender of last resort and allowed the political conflict to escalate. Even a deficit of -1.4% of GDP in 1930 was enough to lead to extreme political confrontation and lay the foundations for violence.

What does this case study tell us about the current situation?

It is clear that Cyprus faced the most severe economic depression during the period 1929-1933, making its current economic malaise seem shallow in comparison. The fall of income for the majority farming population was very severe, making them much more resistant to the government efforts to decrease its disposable income through taxation increases, and more prone to incitements of violence.

A country cannot afford a tax system that is more cyclical than income. A large part of the problem in colonial Cyprus was that any increases in taxation resulted to lower than expected increases in revenue. This was due to the fact the tax system based itself largely on two very cyclical elements of the economy: Trade and Agriculture. A broader tax system can be more stable and reduce the disproportionately large effect a global crisis can have on the government revenue .

The size of a country's deficit is less important that other factors such as the general situation in the economy and the lack of lender of last resort. The lack of a lender of last resort is a crucial weakness in the current Eurozone system and Cyprus in 1930 indicates that: a severe budget deficit crisis occurred in 1930, even though the deficit was -1.4% of GDP and well within the Growth and Stability pact criteria, although failing the more recent criteria for fiscal prudence (-0.5% of GDP).

The lack of lender of last resort is the major issue affecting the debt crises, and it is more important than the actual size of the debt itself. A commitment by the colonial office to cover any shortfall would have partially absolved the need for political conflict in Cyprus. Politics would not become so polarised if there was the ability for Cyprus to borrow in the short term. In extreme economic downturns political sides can feel the pressure of the economic situation and believe it is time for action and not words: as a result they could act in a way that would make the violence likely.

Likewise an understanding of a need of a lender of last resort in the Eurozone would be much more effective in controlling debt crisis than the additional measures suggested by the new Eurozone agreements. Fiscal restriction is no alternative to the ability to borrow without question by a lender of last resort: debt crises can occur even if the debt is at much lower levels, and the fiscal policy is more restrictive. What matters is not so much the size of the problem but the ability of countries that are in trouble to get the sort of help they need to tie them over. Even with very limited government debt and a small deficit, governments that do not have independent monetary policy can come to situations that create economic turmoil and political deadlock.

The implication of the new Eurozone rules is to follow a very restrictive government role even when the economy is expanding. Under a system with restrictive fiscal and monetary control government expenditure should not rise faster than GDP but surpluses saved for balancing losses. One could point out that if Cyprus saved all its surpluses from 1921 to 1929 then it would have easily weathered the storm inflicted on government finances in 1930/1931 without the need for tax increases or a lender of last resort. A strictly balanced budget rule needs exactly that: Cyprus despite having surpluses Cyprus in the 1920s expanded the role of government: as a result a 1929 of about 2% of GDP was not enough to avoid the need of a lender of last resort. Hence the restriction on fiscal policy is not just for countries that fail to balance budgets: government growth should not rise faster than GDP growth if there is no lender of last resort.

Microstates such as Cyprus show that such economies are very susceptible to global downturns, since they treat most events as exogenous events (price fall and drought in 1930s, Greek decision for haircut in 2012), which means they lack the means to prevent a normal recession turning to a severe recession. Economic crisis in Cyprus do not just create a government shortfall in revenue, but also affect the credit market with severe credit retrenchment. This is not just for Cyprus but more valid in small states, which are particularly vulnerable in certain situations out of their control. More research is needed on the way to reduce the vulnerability of credit systems in Micro states under monetary unions, and the common banking supervisory agreement will help ease the vulnerability of the credit market of microstates to the global downturn.

In addition the creation of an administrative procedure between London and Cyprus or between Brussels and Cyprus creates delays. These delays rob the local government of the ability to react

to events on the ground and allow time not only for political opposition to organise but also for the political situation to be polarised and reach extremes and violence. The resulting agreements can sometimes seem as lacking in popular legitimacy creating the political friction that can result to violence. Once violence occurs, the advantage that the outside controller (whether it is the colonial office London or the collective of fellow European member states) hoped to gain with the delay and negotiation is lost. More emphasis is needed on the need to reduce social friction in order not to allow violence to occur, as it is counterproductive to all aims.

As a result as much care involving stakeholders should take place as reaching a mutually agreeable deal. Overpowering political opposition to the government plan to handle the crisis has some very dangerous consequences. The government, worried about the lack of funds, decided to overpower the political will of the Cypriots through “orders-in-council”; the Cypriot leadership, feeling the pressure from their communities, felt they needed to do something to show their displeasure at being ignored. We underestimate how a severe economic crisis brings to the forefront a sense of urgency that is unhelpful and polarizing in already stressed political environments. The urgency of “something needs to be done” led to the colonial government sidestepping the legislative assembly rather than undertaking negotiations in order for the deficit to be curtailed, but ensured that with any spark, violence could occur.

The violence had lasting consequences. The October 1931 riots had serious long term effects and coloured the relations of the British and the Greek-Cypriots, eventually leading to the anti-colonial conflict. Holland and Markides argued that “the rupture of October 1931 was to define the polarities of colonial Cyprus for a long time ahead” as it resulted in the final rupture of any sentiments of cooperation that remained in Greek-Cypriot moderates, leading to the EOKA conflict after the Second World War⁵⁰. In addition the Greek-Cypriot leaders moved away from discussing economic considerations and towards demanding union with Greece, thus losing the ability to present a united front with the Turkish-Cypriots against the British, and fostering inter-communal tensions. As the declaration of *Enosis*, became the singular aim of the Greek-Cypriot leadership, it led to direct confrontation against the British and the Turkish-Cypriot community.

⁵⁰ Holland R. & Markides, D. *The British and the Hellenes* (2008) p.186