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THE GRADUATE STUDIES



A RESEARCH STUDY
ON THE ECONOMIC PROBLEMS
OF TRNC

&
THE PROPOSALS and SOLUTIONS

By

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PREFACE

Turkish Republic of Northern Cyprus is a young republic that owns to many economical, social, political and cultural problems. Those problems are always taken into consideration and tried to be investigated by some economist, politicians and some ordinary people, who like to make decisions.

This study on the economic problems of TRNC is investigated and proposals are written for a master thesis for the master degree study. Therefore, it is demonstrating the economic growth trends, developments, problems, opportunities and weaknesses, efficiency and effectiveness, proposals and solutions of the economy of TRNC.

The economy, investment possibilities, incentives and restrictions in front of the economy of TRNC evaluated in deep to find out the major, basic problems for creating a framework for a sustainable development of the economy.

The major problems that is analysed are financial problems, inflation, social security system, incentives, privatization, agricultural facilities, energy, international trade, and the most important problem; populous politics found out.

While the reader, starts to read the thesis each part may become attractive than the other one.

ACKNOWLEDGEMENTS

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1. INTRODUCTION

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1. INTRODUCTION

Turkish Republic of Northern Cyprus is settled at the north side of the island of Cyprus, which is situated in the Eastern Mediterranean Sea at the Southern coast of Turkey. TRNC has been an independent country since it is established its republic in 1983.

TRNC has many political, economical and social problems, which are not solved yet, in the international area. That is why, TRNC firstly needs to be evaluated on historical development, international politics and on community side. But in this work, this side of the country does not taken into evaluation properly but the economy, investment possibilities and the restrictions in front of the economy that has not being investigated before are being evaluated in deep.

This thesis aimed to put into consideration and to analyse TRNC's economic problems and the structure at whole, to advise proposals for solution. In the second part, the economic conditions of the economy is being determined, also in this part the determined conditions being evaluated if they are related with the macroeconomic developments.

In the third part the restrictions in front of the TRNC's economic development and the economic problems at the macro bases are discussed. In the forth part of the thesis, proposals for a sustainable development on investment and on economic activities discussed.

2. ECONOMY OF TRNC

The Turkish Republic of Northern Cyprus economy carries the characteristics of being an island country. Limited resources and the energy are the main problems of the island economies. The other important problem of TRNC is not recognised by the other countries except Turkey.

The closed economic, social and political relationships between Turkey and using Turkish Lira as the money in flow directly affects the structure of TRNC's economy.

The suitcase trade and the tourism between Turkey supported the economy after 1974. However, in time, Turkey developed its foreign trade so the suitcase trade started to decline. Between the years, 1989-1991 looses for the production lived in the agricultural sector, which causes recycling in the economic growth of the country. The gulf- crises lived in 1991 and the fast devolution of Turkish Lira in 1994 causes the structural problems to come out.

The populace politics are always done to increase the prosperity of (wealth level) the society in a short time. This aim did not made stabilised growth but within a time these politics brought out congestion in social security, cause public employment to increase and the public deficit to grow up. Because of not being recognised, the TRNC's foreign trade faced with handicaps as long as the domestic market is too small to cover the supply. The hesitation of the economy is unavoidable if the populace politics are still on application. The clues for this situation must be evaluated in a right way to solve this problem in a short period. This problem seem to be hard for TRNC to solve it within its own dynamics so it is

clear that Turkey has important liabilities on this problem to solve it.

TABLE 1. BASIC MACROECONOMIC INDICATORS

	<u>1977</u>	<u>1982</u>	<u>1987</u>	<u>1992</u>	<u>1996</u>
Growth Rate (%)	5.8	11.2	6.8	7.8	2.9
Population (1000 person)	145.0	153.2	165.0	175.1	183.3
Income per Capita (us \$)	1444	1361	2009	3343	4222
Inflation (year end, %)	23.0	33.2	43.0	63.4	87.5
Unemployment (%)	2.9	2.4	1.8	1.0	1.2
Working Population (1000 person)	44.8	56.8	66.2	74.0	79.0
Population Work in agriculture (%)	42.0	37.3	29.9	25.0	21.2
Import (US \$ million)	82.0	119.9	221.0	371.4	318.4
Export (US \$ million)	24.9	39.5	55.1	54.6	70.5
Production Ind. Export/ Total Export (%)	12.1	18.7	42.6	42.8	54.5
Balance of Foreign Trade (US \$ million)	-57.1	-80.4	-165.9	-316.8	-247.9
Net Income From Tourism (US \$ million)	30.2	27.2	103.5	175.1	175.6
Balance of Current Operations (US \$ million)	-25.0	-28.4	-20.7	-23.4	2.0
Reserves of Foreign Exchange (US \$ million)	2.1	18.3	115.8	234.0	510.9
Total Bank Deposits (US \$ million)	98.7	60.3	156.6	395.0	648.1
Total Accommodations for Tourists	46.0	49.0	64.0	86.0	99.0
Capacity of Bed for Tourism	3265.0	3782.0	4352.0	7087.0	8267.0
1 US\$	18.2	163.8	872.0	6896.3	82150.5

2.1. Population

The 36 % of the island of Cyprus owned by TRNC. The 59% owned Greek Cypriots and the 5% are under control of United Nations and British colony. According to the population census done in 15th of December 1997, it was

188,662. After 1977, the population rates are increased regularly, and in last 10 years, the average increasing rate was 1.1%. The 60.2% of the population live in the villages and the rest 39.8% lives in centres. The total population rate under age 14 is 27%. The expected age for life is 72 years; according to the estimations done in 1994 the death rate is 0.8%.

The education level in TRNC is high. The rate of education was 93% and the share of university graduates over the age six reaches to 6%.

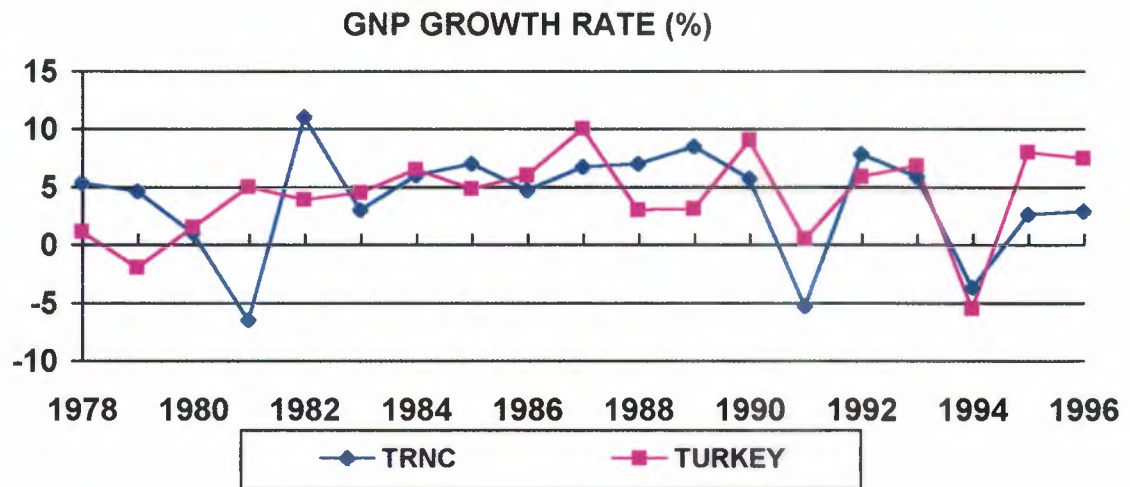
TABLE 2. GROSS NATIONAL PRODUCT

	GNP (Billion TL)		GNP (Million US\$)	Per Capital (GNP US\$)	Growth Rate (%)	Population (Million)	1 US\$=TL
	Current	Fixed					
1989	910	6.6	425.4	2,513	8.5	169.2	2,139
1990	1,547	7.0	591.0	3,547	5.7	171.5	2,618
1991	2,273	6.6	541.4	3,116	-5.3	173.8	4,199
1992	4,038	7.1	585.5	3,343	7.8	175.1	6,896
1993	6,941	7.5	624.9	3,528	5.9	177.1	11,106
1994	16,582	7.3	554.3	3,093	-3.7	179.2	29,915
1995	35,179	7.5	755.7	4,167	2.6	181.3	46,554
1996	63,577	7.7	773.9	4,222	2.9	183.3	82,150

2.2. General Balance and Economic Growth

After the establishment of Turkish Republic of Northern Cyprus in 15th of November 1983, The economy is observed that, is growing very fast and stabilisation in the economy was easily observed until 1990. The growing rate was fluctuated at very wide intervals but after 1984, it was proceed between the intervals of 5% - 9% until 1991. The protocol was done between Turkey and TRNC in 1986 fastened the process of transition to Free Enterprise System.

Investments on Public Services, communication-transportation, and especially on the production sector reactivated the economic activities. The expected growth rate increased to 7% in 1987-1990 according to the period 1978-86. Gulf-Crises lived in 1990 directly affected TRNC's economy and the growth rate decreased to 5.7% in 1991. At the same time in 1991, poly-peck case; caused investment to stop, and this situation had the same outcome as lived in Gulf-Crises. The growth rate decreased as much as Gulf-Crises. After 1990, the agricultural sector was unlucky and drought lived in this sector in 1991, upon all these, the economy gets smaller as 5.7%. Economy in 1992 and 1993, because of the investments done in the communication – transportation and in the commercial sector showed an increased growth rate of 7.8% and 5.9%.



In 1994, crises lived in Turkey affected TRNC in deep. The inflation lived in Turkey directly show its effects in TRNC, the inflation of TRNC and the interest rate increases at the same time. The main reason for this, is the use of same currency as the legal tender (Turkish Lira). 25% of the export is done to Turkey, but this was fallen down because of Turkey's domestic market in the light of the crises lived, decrease the demand for the TRNC's goods. Therefore, the economic activities slow down and the economic tightened occurred again after 1981 and 1991. In addition, the drought lived in the agricultural sector in the same year decreased the production of the economy at 12%.

According to the data taken from State Planning Organisation, the growth rate expected to be 6% in 1997, but this was happened 1.7%. The reason for this was the 30% declining in the agricultural sector. According to the situation above, the GNP expected to be 116.4 trillion Turkish liras at the current prices (770 Million \$). In addition to this per capital expected to stay same, 4200 \$.

TABLE 3. GENERAL BALANCE OF THE ECONOMY

Current Prices (Billion TL)

	1993	1994	1995	1996
I. TOTAL RESOURCES	6,952	19,707	35,751	63,741
1. GNP	6,941	16581	35,179	63,577
2. Foreign Deficit	11	126	572	164
II. TOTAL INVESTMENT	1,197	2,388	4,826	9,899
1. Fixed Capital	1,049	2,215	4,247	8,842
a) Public	407	781	1,153	3,787
b) Private	642	1,434	3,094	5,055
2. Exchange of Stock	148	173	579	1,057
a) Public	45	33	123	373
b) Private	103	140	456	684
III. TOTAL CONSUMPTION	5,754	14,319	30,925	53,841
IV. INCOME FOR PUBLIC EXPENSES	1,527	3,946	4,967	10,858
1. Public Consumption	1,523	3,945	8,079	14,229
2. Public Savings	4	1	-3,112	-3,371
3. Public Investment	452	813	1,275	4,160
4. Public Savings- Investment Difference	-448	-812	-4,387	-7,531
V. INCOME FOR PRIVATE EXPENSES	5,413	12,634	30,212	52,718
1. Private Consumption	4,231	10,373	22,846	39,612
2. Private Savings	1,182	2,261	7,366	13,106
3. Private Investment	745	1,574	3,551	5,739
4. Private Savings-Investment Difference	437	687	3,815	7,367
Private Saving Ratio (%)	21.8	17.9	24.4	24.9
Tendency of Marginal Private Savings (%)	21.8	14.9	29.0	25.5
VI. TOTAL DOMESTIC SAVINGS	1,186	2,262	4,254	9,735
Total Tendency of Marginal savings (%)	24.4	11.2	10.7	19.3
Investment/GNP (%)	17.3	14.4	13.7	15.6
Saving/GNP (%)	17.1	13.6	12.1	15.3

According to the estimations of State Planning Organisation, In 1997, 16.2% of the total resources spend on investment activities, the rest was spend on consumption expenditures. 44% of the total investment done by the public and the rest 56% of investment done by the private sector. The proportion of the domestic savings to the GNP was 13.9% and the proportion of the investment to the GNP was 16.6%. As for the proportion of the private sector's savings to the GNP was 17.6%.

TABLE 4. SHARE OF SECTORS IN GNP (%)

SECTORS	1989	1990	1991	1992	1993	1994	1995	1996
AGRICULTURE	9.9	9.2	8.3	10.2	10.6	8.8	10.0	9.6
INDUSTRY	13.6	12.4	13.4	12.7	10.8	9.8	12.9	13.0
TRADE – TOURISM	23.0	23.5	20.7	18.2	20.5	21.8	18.3	14.4
PUBLIC SERVICES	14.5	16.8	19.2	18.6	18.5	21.6	20.3	19.4
OTHER	39.0	38.1	38.4	40.4	39.7	38.1	38.4	43.6
TRANSPORTATION-COMMINC.	10.1	9.5	8.4	9.0	8.5	9.4	8.5	10.3
CONSTRUCTION	6.7	5.6	7.0	7.8	6.4	5.4	3.7	3.0
FINANCIAL INSTITUTIONS	5.7	5.0	6.5	7.2	6.6	6.9	11.0	10.8
INCOME FROM HOUSE	1.9	1.5	1.9	1.9	2.0	1.9	1.8	2.1
SELF-EMPLOYEED AND SERVICES	5.3	5.4	6.0	5.9	5.8	5.5	5.4	9.8
IMPORT TAXES	7.9	10.5	7.9	8.0	8.9	7.4	6.7	7.1
NET FACTORIAL INCOME	1.3	0.6	0.8	0.6	1.6	1.7	1.3	0.5
GNP	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

TABLE 5. SECTORIAL DISTRIBUTION OF FIXED CAPITAL INVESTMENTS (FIXED PRICES, %)

	1989	1990	1991	1992	1993	1994	1995	1996
I. AGRICULTURE	2.4	5.9	6.9	4.6	7.7	10.3	4.9	6.9
II. INDUSTRY	13.4	11.5	12.7	13.6	12.7	8.7	10.0	10.0
1. Production	10.1	8.4	9.4	8.3	8.9	6.0	6.9	7.9
III. CONSTRUCTION	1.6	1.5	3.1	1.5	2.6	1.5	2.8	2.0
IV. TRADE – TOURISM	12.2	14.8	7.2	10.0	9.0	9.7	7.4	10.0
1. Trade	7.8	8.8	4.7	8.4	5.2	6.3	4.9	6.2
2. Tourism	4.3	6.0	2.5	1.6	3.8	3.4	2.5	3.8
V. TRANSPORTATION-COMMUNIC.	9.9	12.3	27.7	10.8	17.2	23.8	20.8	19.9
VI. FINANCIAL INSTITUTIONS	1.4	0.6	0.1	1.2	0.6	1.0	0.9	1.1
VII. RESIDENCE	49.6	39.8	32.3	46.1	40.2	33.5	39.6	38.8
VIII. FREE-ENTERP. AND SERVICE	2.8	3.7	3.0	3.6	2.3	1.9	2.7	2.9
IX. PUBLIC SERVICES	6.8	9.9	7.0	8.6	7.5	9.7	10.9	8.4
TOTAL	100	100	100	100	100	100	100	100

TABLE 6. SPEED FOR INCREASE OF FIXED CAPITAL INVESTMENTS (FIXED PRICES, %)

	1989	1990	1991	1992	1996	1994	1995	1996
I. AGRICULTURE	139.1	32.7	-35.6	55.3	60.3	-59.0	29.2	88.7
II. INDUSTRY	-14.3	25.0	3.0	-13.7	-17.5	-2.0	-7.2	-13.3
1. Production	-16.8	26.6	-15.0	-1.2	-17.9	-2.9	6.0	-19.7
III. CONSTRUCTION	-6.7	135.7	-54.5	66.7	-32.0	58.8	-33.3	33.3
IV. TRADE – TOURISM	20.9	-44.6	32.5	-16.7	30.6	-35.1	25.0	-15.6
1. Trade	12.2	-39.8	72.0	-43.0	46.9	-33.3	16.7	-33.9
2. Tourism	36.6	-51.8	-40.7	125.0	8.3	-38.5	41.7	14.7
V. COMMUNIC- TRANSP.	23.7	156.5	-62.7	48.2	66.3	-25.5	-11.4	61.5
VI. FINANCIAL INSTITU.	-53.8	-83.3	1100.0	-50.0	83.3	-18.2	11.1	-10.0
VII. RESIDENCE	-20.3	-7.8	36.6	-19.1	0.5	0.8	-9.1	-20.6
VIII. FREE ENTERP& SERV.	34.6	-8.6	15.6	-40.5	0.0	18.2	0.0	19.2

IX. PUBLIC SERVICES	45.3	-19.4	17.3	-19.3	56.3	-4.5	-28.3	118.4
TOTAL	-.05	13.5	-4.2	-7.4	20.7	-14.8	-7.3	18.5

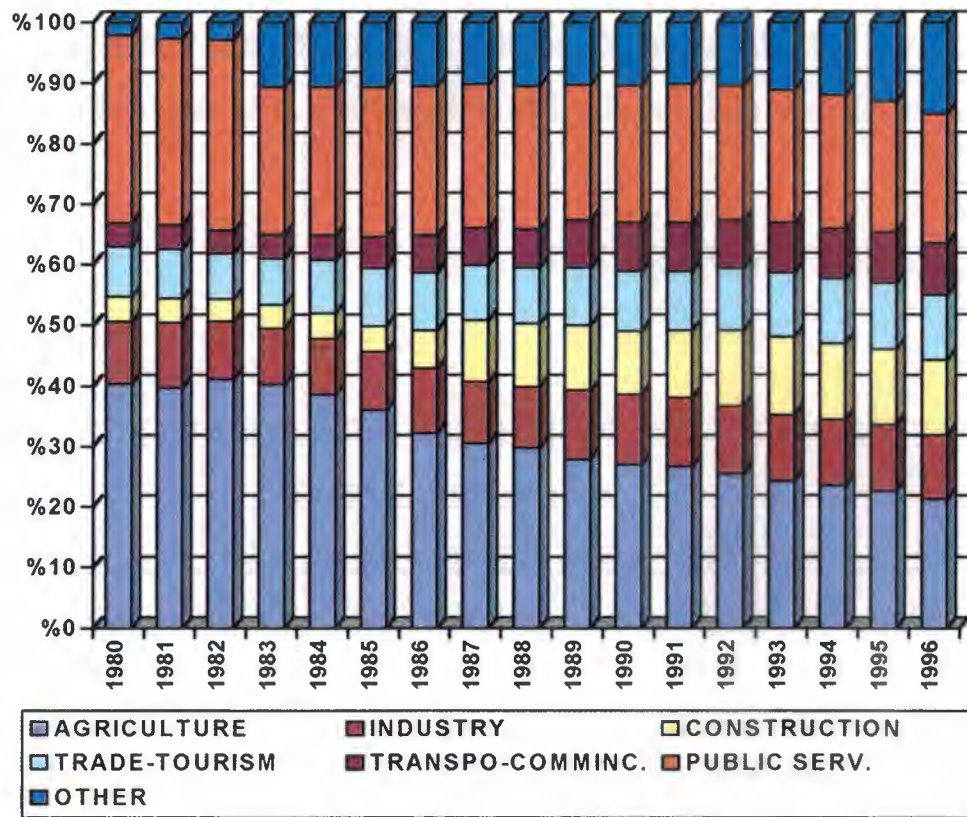
2.3. Employment and Social Security

Government has the biggest site to be the employer. The given wide social rights and high salaries from the government to public workers cause working power markets to loose its flexibility. The social security system that covers all the society and the guarantee given by the government for the employment creates an obstacle in front of private employment is, not being developed. This is one of the important factors which makes a heavy weight on TRNC' s economy.

2.3.1. Employment

According to the 1996' s data, the participation to the working power was 68%. The biggest portion, 21.3% of 79,368 workers works in the public sector. The 21.2% of the employed population work in the agricultural sector, 12.4% works in the rapidly growing sector construction, 10.5% works in tourism and communication sector and the workers in the industrial sector are 10.5% of all.

Sectorial Distribution of Employment



In 1977, 42% of the working population was working in the agricultural sector, thus this portion decreased to 30% in 1987 than to 21.2 % in 1996. 16,899 people work in the public sector that includes the State Economic Enterprises and the municipalities. In other words, 1/5 of the working population works in the public services. In TRNC, having a job or working in the public sector has much more advantages than working in the private sector. The working hours of the public sector is less 10-15% than the private sector's working hours. Public sector

workers have 45 days in each year as permission for holiday, 42 days for medically or illness excuses and the other social benefits that are very attractive to work in the public sectors rather than the private sectors. Consequently, the person whom works in the public sector gets more wages and salaries than the person works in the private sector.

**TABLE 7. SECTORIAL DISTRIBUTION OF THE WORKING
POPULATION (%)**

SECTORS	1989	1990	1991	1992	1993	1994	1995	1996
I. AGRICULTURE	27.6	26.7	26.2	25	24	23.4	22.8	21.2
II. INDUSTRY	11.3	11.3	11.2	11	10.8	10.8	10.9	10.5
III. CONSTRUCTION	10.6	10.4	10.9	12.3	12.7	12.6	12.5	12.4
IV. TRADE-TOURISM	9.4	9.7	9.6	10.1	10.5	10.6	10.9	10.6
V. TRANSP.-COMMINC.	7.9	8	8	7.8	8.2	8.2	8.5	8.5
VI. FIN.INSTITUTIONS	2.6	2.7	2.8	2.8	2.8	2.9	3.1	3.1
VII. FREE ENTERP& SERV.	8.4	8.8	8.9	9.1	9.2	9.6	9.6	12.4
VIII. PUBLIC SERVICES	22.1	22.3	22.4	21.9	21.7	21.9	21.7	21.3
TOTAL	100	100	100	100	100	100	100	100

Data: State Planing Organisation

2.3.2. Unemployment

According to the statistics in 1996, the number of unemployment was 946 and the rate was 1.2%. However, this statistics depends on the unemployed persons whom made their register to the department of working branch of the government. It is not possible to say the society has living an intensively unemployment because the total population whom reach to the working age was 110.000, and the amount of employed population was 79.368. Therefore, the rest is approximately 30.000 person, where the 17.500 of them are students, and the rest are those whom retired early and the house-wife.

Therefore, unemployment can be seen in the high school educated young population of the TRNC. The university graduated young society leaves the country when they get their certificates because they tries to implement their education but they found themselves in Turkey or in other foreign countries. This implies us that so many people are working under their capacity.

2.3.3. Social Security

In TRNC the social security system and the worker rights are higher than the standards of many countries. The institutions which extent into the social security system in TRNC are; Social Security Institution, Reserve Fund, Pension Fund and the Department of Social Services. The existing social security system includes all

the society into the extended social security system. In addition, a social insurance for unemployment is available. The population over age 50 was 37,395 person of overall population and the amount of people taking wages from those institutions was 33.569.

2.3.4. Worker Unions

Both the private and the public sector workers have the rights to be organised in the unions. Total workers whom are organised with the unions are 22.390. If it is recognised that total amount of employment in TRNC is 79.368 than the portion of the workers joined into the worker unions comes out as 28%.

The workers in TRNC have the rights to make strikes against their employer. In fact, the public sector workers mostly use the strikes to influence the employer for increasing their wages and salaries and for gaining other social rights. However, the workers of the private sector can not do this.

2.3.5. Minimum Wage

In TRNC, the minimum wage determined one or two times in a year. The minimum wage is out of taxation. According to the statistics in last 10 years, the minimum wage is increased depending on the increase of the inflation rate. The minimum wage in 1998 was 50.250.000 TL and in 1999 this amount increased to 85.000.000 TL.

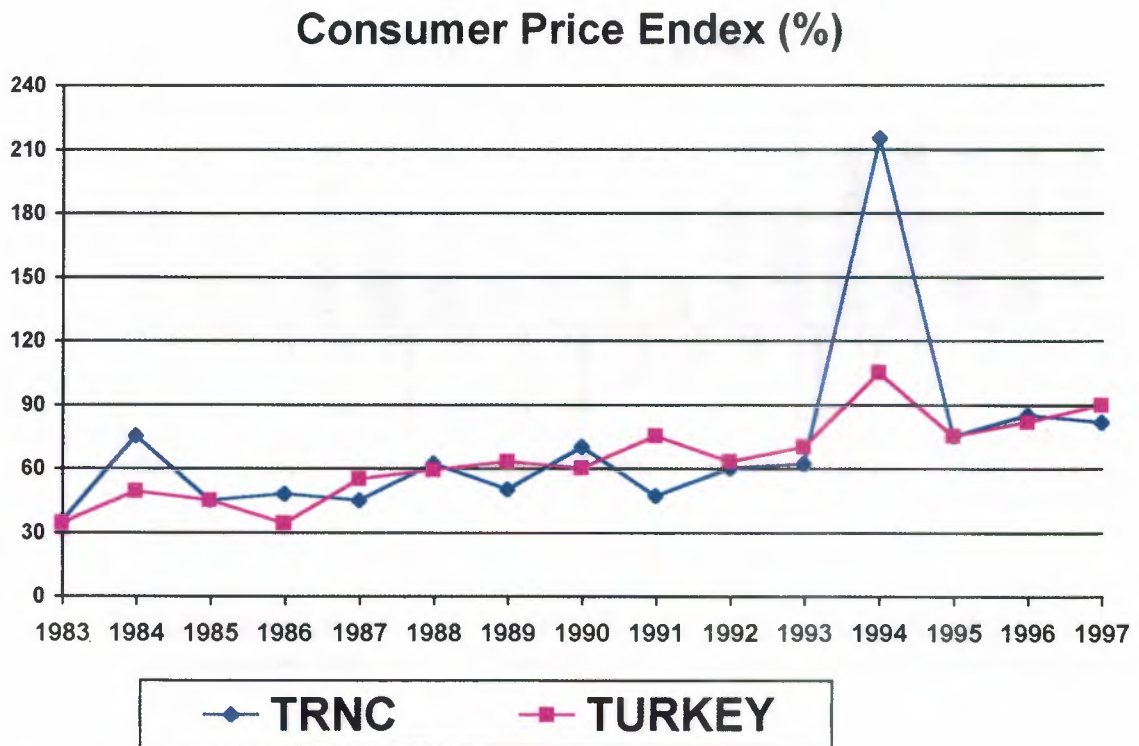
TABLE 8. DEVELOPMENT ON WAGES

<u>Years</u>	<u>Application Date</u>	<u>Minimum Wage(TL)</u>	<u>% Increase</u>	<u>Index of real wage</u>
1989	1/1/89	205.000	69.4	100.0
1990	1/1/90	304.500	48.5	97.9
1991	1/1/91	520.000	70.8	98.6
1992	1/1/92	806.000	55.0	104.5
1993	1/1/93	1.373.000	70.3	109.0
1994	1/1/94	3.000.000	118.5	147.7
	1/8/94	5.000.000	66.7	98.7
1995	1/1/95	9.420.000	88.4	129.2
	1/9/95	11.590.000	23.0	99.3
1996	1/1/96	14.800.000	27.7	105.5
1997	1/1/97	23.000.000	55.4	87.5
	1/9/97	33.800.000	68.0	76.5
1998	1/1/98	50.250.000	48.7	94.7

2.4. Inflation

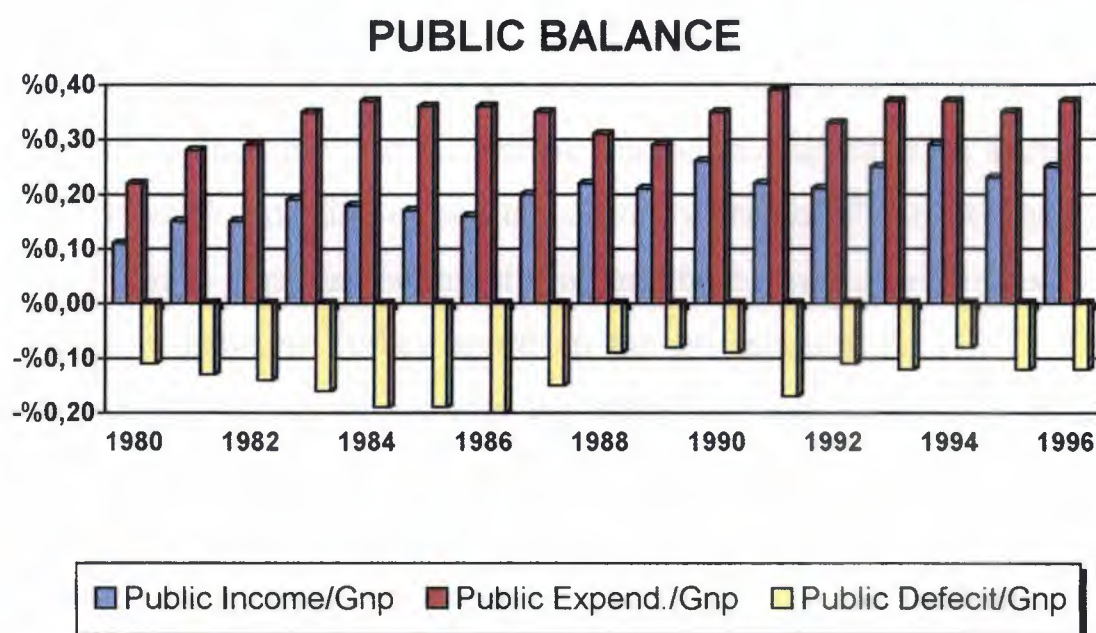
Although the Turkish Lira recognised as legal currency in TRNC, the inflation happening in Turkey directly affects the economy of TRNC. The inflation of TRNC goes parallel with the inflation of Turkey. Having a small economy, this causes an inadequate local production, where causing the inflation to be fluctuating.

In general, the parallel inflation between TRNC and TR had been deeply affected by the 1994 economic crisis lived in Turkey. At that time the inflation in TRNC happened twice as the inflation of TR. The inflation of Turkey was 105% and the inflation of TRNC was 215% at that time. Later in 1997, the inflation of TRNC decreased to 81.7% like as in Turkey.



2.5. Public Finance

The general balance of TRNC's economy always had high deficits until 1988. Between 1998 to 1990 the public income had increased and the expenditures are decreased, so the need for credit of the public stayed at 3% of the GNP. The gulf crisis in 1990 and the unexpected economic situation lived in 1991 cause stagnation happening in the economy so this decreased the public income and increased the social expenditures. According to this the ratio on the GNP to a need for the public finance increased to 8%. Between the period of 1995-1996 the current expenditures of the public increased 100% more, depending on this the need for the public finance increased more than 10% of GNP. The help of Turkey always covers the need of the overall need of the public finance.



In 1996, only 64% of budget expenditures covered by the local income. 25% of the budget expenditures covered by the help of Turkey and 9% covered by the domestic loans and debts. Tax income in 1997 would expect to cover only the current expenditures. If looked up to the public budget in 1996, the expenditures constitute from 38% personnel expenditures and from 32% social transfers. This is because the heavy pressures done by the public on the economy. 17 thousand people work in the public services and behind of this 10 thousand people are taking retirement wage and social help wage from the public budget.

Scholarships to students, social helps to poor people, health helps are all social transfers, which are all included into the budget. After 1994, the retirement wages and social help wages matched to the total personnel expenditures. Between the period of 1994-1997, the amount of personnel and the personnel expenditures in the public services aimed to be decreased and through this period, the government stops taking new personnel to its services.

By the time being, the social transfer expenditures increased by 400% at the rate of 14% share on the GNP. The tax income and the income out of tax started to uncover the personnel expenditures and the deficit of the social security system. The help from Turkey finances the investment and the defence expenditures. The protocol had done between Turkey speed up the privatization in TRNC. This privatization carries the aim to increase the efficiency and the activity of the economy, but this aim lived difficulties because of strong worker unions.

TABLE 9. GENERAL BALANCE OF PUBLIC
(Current prices, billions TL)

	1993	1994	1995	1996
I. PUBLIC INCOME	2.401	6.230	10.753	20.674
1. Taxes	1.407	3.161	6.300	11.648
a) Indirect Taxes	743	1.814	3.672	6.596
b) Direct Taxes	664	1.347	2.628	5.052
2. Other Income	338	855	1.982	3.631
3. Factors & Fund Income	656	2.214	2.471	5.395
II. TRANSFERS	874	2.283	5.787	9.816
III. PUBLIC INC. FOR EXPENDITURES	1.528	3.947	4.966	10.858
IV. PUBLIC CURRENT EXPENDITURES	1.523	3.945	8.079	14.229
V. PUBLIC SAVINGS	4	1	-3.112	-3.371
VI. PUBLIC INVESTMENT	452	814	1.276	4.160
1. Fixed Capital	407	781	1.153	3.787
2. Change of Stock	45	33	123	373
VII. NEED FOR PUBLIC FINANCE	448	813	4.388	7.531

TABLE 10. BALANCE OF PUBLIC BUDGET
(Current prices, Billion TL)

	1993	1994	1995	1996
I. DOMESTIC INCOME OF BUDGET	1.690	4.748	8.463	15.528
1. Income From Tax	1.393	3.129	6.203	11.367
a) Indirect Taxes	728	1.814	3.661	6.519
b) Direct Taxes	665	1.315	2.542	4.848
2. Other Income	297	758	1.609	3.138
3. Income From Funds		861	651	1.023
II. BUDGET EXPENDITURES	2.505	6.259	12.905	24.381
1. Current Expenditures	1.163	3.037	5.513	10.672
a) Personnel Expenditures	974	2.669	5.509	9.276
b) Other Current Expenditures	189	368	4	1.396
2. Transfers	901	2.303	5.794	9.867
a) Social Transfers	694	1.821	5.003	7.682
b) Other Transfers	207	482	791	2.185
3. Defence	126	310	748	1.248
4. Investment	315	609	850	2.594
III. FOREIGN HELP & CREDITS	814	1.512	5.192	8.853
1. Foreign Helps	296	632	1.295	6.227
a) Helps From Turkey	292	621	1.254	6.120
b) Other Helps	4	11	41	107
2. Borrowing	518	880	3.897	2.626
a) Domestic Borrowing	517	880	3.897	2.126
b) Foreign Borrowing	1	-	-	500
GNP	6.941	16.581	35.179	63.577

75% of the income for the budget is covered by taxation, but after 1993, tax income started to show big decreases. In 1990, the portion of taxation in GNP was 21.4%, but after this year this portion decreased and fluctuated between 18% - 20%. According to this, in 1996, this portion was 17%. 57% of total tax income collected from direct taxes and 43% collected from indirect taxes.

There were 20.956 taxpayers in 1996 but 60% of taxation comes equal to the tax applied on the public workers' wages. The taxation of the private sector is too low. The rate of institution tax is 25%. At the end of 1996, there were 2.605 active institutions, which paid 1.6 billion TL taxes. Consequently, an institutional taxpayer paid 615 million TL on average. Value Added Taxation (V.A.T) put into application in 1996. This system had accomplished as 70% - 80%. Those workers whom collects invoices had get tax repayment in every four months at the rate of 5%.

2.6. Financial Sectors

As a matter of fact, TRNC is using the money of another country, so the money supply can not be controlled by the central bank of the country. Money supply depends on the trade between Turkey and the capital movements done between TRNC – TR. According to the fact, the emission can not be under control of the Central Bank of TRNC. So the interest rates and exchange rates are imported to the country. 1/3 portion of the resources of central bank are legal deposits. The rest of 1/3 are saving deposits. The rate for legal deposits is 15% and the central bank pays 12% annual interest to those deposits. The biggest portion of the saving

deposits occurs from the money taken from Turkey.

TABLE 11. DEPOSIT ACCOUNTS ON TL. (Billion TL)

	1989	1990	1991	1992	1993	1994	1995	1996
Demand Deposits	61	78	123	266	588	1.239	2.619	7.984
Time Deposits	234	417	724	1.258	2.536	4.251	7.747	11.866
Total	295	495	847	1.524	3.124	5.490	10.366	19.850

In TRNC, 37 banks give services with there 1.000 employers. Nearly half of those banks were established after 1993. Beside to those banks, 34 offshore banks are also giving services in TRNC. 50 billion TL is enough to open a bank in the country. The main reasons for opening offshore banks are, it is easier to open a bank in TRNC rather than opening in Turkey, so the banks of Turkey open branches in here and also those banks which do not have branches in Turkey can make agreements with the banks in Turkey to make transactions.

However, the main reason for opening offshore banks in TRNC is the expectation of Cyprus to integrate into European Community. Accordingly, if a bank has a branch in Cyprus will have many advantages on operations to being a bank of the country that is the member of EC.

The assets of the banks (except offshore banks) have a share of 149% in the GNP. This rate is very high if compared with Turkey and other countries. The 66% sources of the banks are from deposit accounts, 7% are from paid capital and 4% from credits.

The most important resource of a bank is the deposit accounts. At the end of 1996, 70% of total deposit accounts are foreign currency type and 30% are TL. 85% of the total deposit account are from saving accounts. For the aim of 15% and

10% for being cash at every time is, decreasing the risk of the banks so the government applied high legal saving deposits. Therefore, this application increases the cost of the funds. Banks are paying 85% - 90% interests on time deposits quarterly and applying 140% - 150% on credits annually.

TABLE 12. SECTORIAL DISTRIBUTION OF BANK PLASMAN

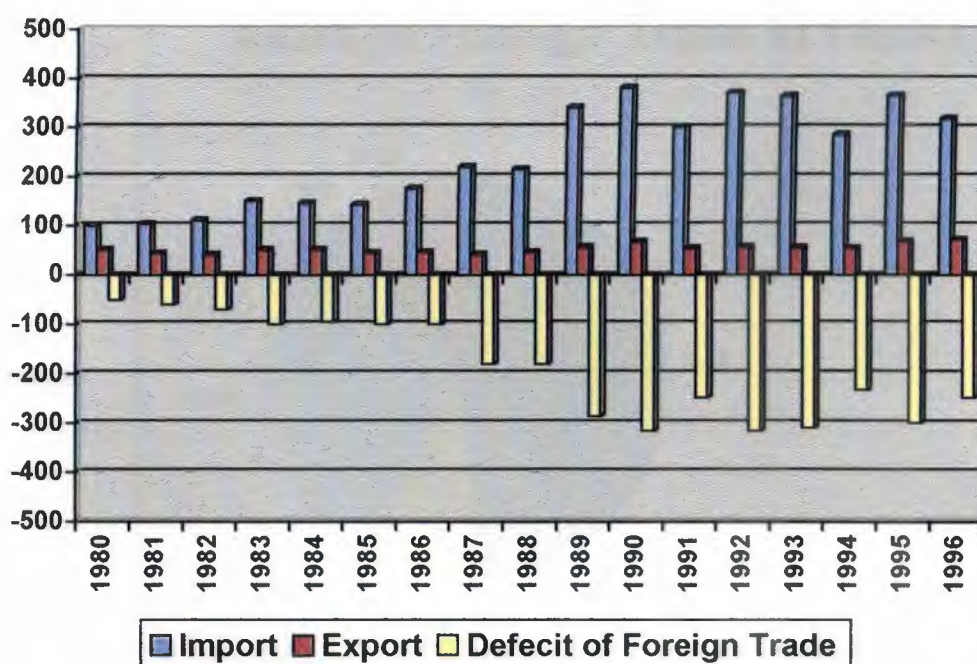
SECTORS	1989	1990	1991	1992	1993	1994	1995	1996
Public Institutions & Societies								
Agriculture	27	65	73	180	477	1.184	2.023	5.888
Stone Quarry	0	4	0	0	8	0	0	82
Production Industry	9	17	41	48	110	191	412	1.036
Transportation of load	2	9	28	43	240	603	827	2.127
Foreign & Domestic Trade	89	215	312	727	1.429	2.934	10.767	20.409
Building & Construction	10	13	13	20	44	179	281	713
Tourism	9	22	39	76	130	304	759	1.566
Private & Professional Debts	18	44	70	136	592	2.678	6.132	5.925
Small-Scale Retailer	6	8	4	31	58	35	28	97
Total	173	402	483	1.265	3.092	8.112	21.232	37.874

Nowadays banks are investing their surpluses in Turkey, such as into REPO and into the Government Bonds. Some banks thing bigger and invests their money surplus into stock exchange market.

2.7. Foreign Trade, Tourism and Balance of Payment

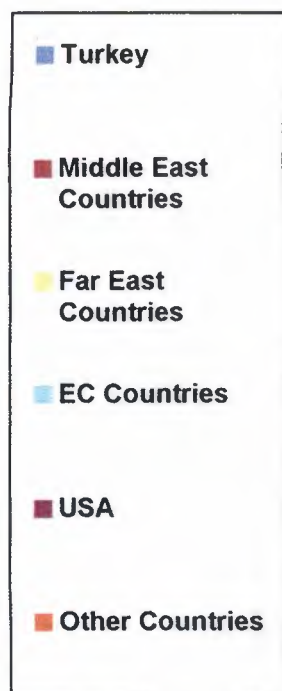
The economy of TRNC highly depends on imports and restricted possibilities of making export cause to have high deficit on foreign trade balance. That is the another biggest problem of the economy. The raw materials are also imported from out, so the share of import to the GNP reached to 41%. Lack of domestic production and high price of transportation destructed the development of export.

**Balance of Foreign Trade
(Million \$)**



Generally, the agricultural products are the exporting materials, which has 9% share of GNP. The European Community takes the most important restriction on the export of TRNC. EC give an order to the European countries not to buy or import the agricultural products of TRNC and applies high rates of tax on the industrial products of TRNC if they import them. Mainly, EC put basic restrictions on exporting products from TRNC. The trade balance of TRNC always gives minus deficit of 30% - 35% rates on GNP.

The total export of TRNC in 1996 was 70 million dollars. The import was 318 million dollars and the trade deficit was 248 million dollars. In 1997, trade deficit increase to 282 million dollars because of the increase in import. The 85% of the total trade done between Turkey so the biggest trade partner is Turkey.



Avarage Foreign Trade in 1990-1996

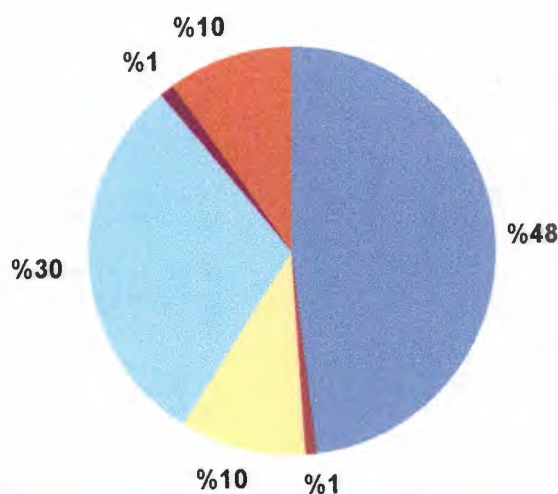


TABLE 13. FOREIGN TRADE IN RESPECT TO COUNTRIES

MILLION \$

	1989		1990		1991		1992		1993		1994		1995		1996	
	Imp.	Exp.	Imp.	Exp.	Imp.	Exp.	Imp.	Exp.	Imp.	Exp.	Imp.	Exp.	Imp.	Exp.	Imp.	Exp.
I. TURKEY	160.9	9.2	153.5	7.9	143.0	7.3	178.7	9.1	150.9	12.5	129.3	10.4	194.8	20.2	176.1	34.0
II. OTHER COUNTRY	180.4	46.0	228.0	57.6	158.1	45.2	192.7	46.7	213.0	42.0	157.3	43.0	171.3	47.1	142.3	36.5
1. EC. Countries	103.5	40.2	131.1	51.0	92.9	42.0	91.4	41.8	121.7	36.4	104.4	34.2	102.0	36.5	81.0	24.7
a) UK	55.8	35.2	67.1	44.0	45.7	35.4	45.5	36.3	65.4	26.7	73.4	24.7	49.4	23.8	44.0	15.0
b) Other EC	47.7	5.0	64.0	7.0	47.2	6.6	45.9	5.5	56.3	9.7	31.0	9.5	52.6	12.7	37.0	9.7
2. Middle East	4.6	3.4	6.4	1.6	4.7	0.7	2.3	1.5	3.2	2.2	2.8	6.5	8.1	1.6	4.6	5.8
3. Far East Count.	3.9	-	52.3	-	32.4	-	37.9	0.1	47.3	0.1	25.0	-	26.8	-	5.4	-
4. USA	4.5	0.8	5.7	3.3	3.4	0.3	7.4	0.1	3.1	0.1	4.5	-	2.8	0.1	4.3	0.7
5. Other Countries	34.0	1.6	32.5	1.7	24.7	2.2	53.7	3.2	37.7	3.2	20.6	2.3	31.6	8.9	37.0	5.3
TOTAL	341.3	55.2	381.5	65.5	301.1	52.5	371.4	55.8	363.9	54.5	286.6	53.4	366.1	67.3	318.4	70.5

TABLE 14. EXPORT IN RESPECT TO SECTORS

MILLION \$

	1989	%	1990	%	1991	%	1992	%	1993	%	1994	%	1995	%	1996	%
I. AGRICULTURAL PRODS.	30.2	54.7	29.8	45.5	27.0	51.4	31.0	56.8	24.3	44.6	25.7	48.1	26.9	40.0	31.0	44.0
1. Citrus Fruits	21.6	39.1	24.5	37.4	21.6	41.1	22.2	40.7	16.6	30.5	15.8	29.6	22.1	32.8	22.6	32.1
2. Potatoes	1.7	3.1	2.4	3.7	2.4	4.6	3.3	6.0	1.3	2.4	0.7	1.3	1.4	2.1	0.9	1.3
3. Live Animal	0.3	0.5	0.3	0.5	0.1	0.2	0.5	0.9	-	0.0	0.3	0.6	0.4	0.6	1.0	1.4
4. Other	6.6	12.0	2.6	4.0	2.9	5.5	5.0	9.2	6.4	11.7	8.9	16.7	3.0	4.5	6.5	9.2
II. INDUSTRIAL PRODUCTS	24.6	44.6	35.2	53.7	25.2	48.0	23.4	42.9	30.0	55.0	27.4	51.3	39.8	59.1	38.4	54.5
1. Treated Products & Agricu.	6.8	12.3	11.9	18.2	8.4	16.0	7.1	13.0	8.2	15.0	7.1	13.3	11.9	17.7	13.2	18.7
2. Other	17.8	32.2	23.3	35.6	16.8	32.0	16.3	29.9	21.8	40.0	20.3	38.0	27.9	41.5	25.2	35.7
III. MINERALS	0.4	0.7	0.5	0.8	0.3	0.6	0.2	0.4	0.2	0.4	0.3	0.6	0.6	0.9	1.1	1.6
TOTAL	55.2	100.0	65.5	100.0	52.5	100.0	54.6	100.0	54.5	100.0	53.4	100.0	67.3	100.0	70.5	100.0

In 1996, TRNC imported 176 million dollars cost of goods from Turkey and exported 34 million dollars cost of goods. The trade deficit between Turkey was 142 million dollars which costs the half of total trade deficit. The other trade partners of TRNC are EC countries which exported 90 million \$ of goods to TRNC and imported 25 million \$ of goods from TRNC.

44% of export was done by agricultural products and 18% was done by treated agricultural products, in other words 62% of export depends on the agricultural products, especially citrus fruits. 30% of export depends on ready-made clothing. Because of tourism, other invisibles incomes and income from universities, inflow high amount of foreign currency resource to TRNC. According to this the current transaction balance does not gives high deficits if compared with the foreign trade balance. For example, in 1996 the current deficit was only 2 million \$ because tourism income and other invisible income was occurred as much as the deficit in the foreign trade.

TABLE 15. INCOME FROM TOURISM AND NUMBER OF TOURISTS

	Net Income from Tourism (Million \$)	Turkish	Foreign Tourist	Total
1989	154.9	214,566	59,507	274,073
1990	224.8	243,269	57,541	300,810
1991	153.6	179,379	40,858	220,237
1992	175.1	210,178	57,440	267,618
1993	224.6	281,370	77,943	359,313
1994	172.9	256,549	95,079	351,628
1995	218.9	298,026	87,733	385,759
1996	175.6	289,131	75,985	365,116

Establishment of universities and the students coming from Turkey to study in these universities makes an important and continuos supply on tourism income. In

the last years, the increasing amount of 13,000 foreign students (approximately 12,000 of them are from Turkey) made a dynamic gain on TRNC's economy. Each student pays nearly 3,000 dollars for school fee and the expenditures they make not only increases the foreign currency gains but also opens new fields to speed up the economic activities

3. PROBLEMS INFRONT OF TRNC'S ECONOMY

3.1. Balance of Public Side

After 1974, because of reconstruction in the economy with the advised model and from this frame work the developing economic activities cause the public sector to have a big share in the economy. After the continuos process of peace operation, a thought that mind out private sector was luck of capital to develop the economy come out. Therefore, these cause public resources to activate on production industry and tourism sector. The aim of this process is the public operations act only at the begging of the process and passed it to the private sector as soon as possible. This economic activity must be evaluated at the beginning of the establishment of economy to transfer into private sector. However, the transfer was not done and the heavy volume of the public on the economy continued for years. This cause populous politics to occur and the public side to blow up. Because of these the public expenditures reached to 40% of the GNP.

Increasing the tax rate, which is 18-20% to decrease the share of total income in GNP, may cause the economic development to slow. Nowadays technology is possible to increase the tax income without increasing tax rates, especially in the economies which has same scale as TRNC. If the activities for tax returns or to increasing tax collection can be applied properly, may take down the tax rates to give a change to the private sector for increasing their power of competition.

In TRNC, it is possible to decrease the public deficit by decreasing the public expenditures. However, reducing the public expenditures may cause to occur a big

open field in the economy, because public side owns a big share in the economic life. Because of this, reduction on the public expenditures must be done in a properly evaluated time. It seems hard to put private sector into the place of public sector if the public sector is taken out from the economy.

Therefore, if a stable efficient investment situation is created, the private sector with the investment possibilities from Turkey may cover may cover the space or the open field where the public side gets smaller.

3.2. Privatization

In the structure where public is still acting in the sectors which private sectors are producing, the public must be taken out from the production activities because public income only covers the current expenditures.

Privatization may stop the unjustifiable competition between public and private sectors; for example, in the industrial sector, if unproductive and continuing losses of the public sector passes to the private may increase the productivity level of production. Specially the privatization in the energy sector must be done as soon as possible.

Distribution of electricity has owns many problems and the electric production and distribution on hand achieve the demand until the year 2000. This case takes attention for the need of activities for reconditioning and the activities for developing the capacity of electric production at the moment.

The costs of those activities are very high so it is hard to be done by the public in the near future. According to the fact, privatization seems to be compulsory, but the public organisations are not paying the cost of the electricity so this causes a big problem for the aim of privatization. If this problem is solved may attract the interest if the firms from Turkey to TRNC.

3.3. Savings and Investment

In TRNC, the private sector has high rate of savings but these savings shows a fluctuating progress. According to official statistics, rate of private sectors' savings fluctuate between the range of 8-25% and the statistics and bank managers support this saving rate is to be very high.

High inflation rate and high rates of interest like in Turkey decreases the economic activities and on the other side, it is very attractive to invest money outside of the country. This aim owns a big scale of TRNC, naturally it is more profitable to invest money to Repo and other investment instruments rather than working and producing at low profit rates. Especially businessmen like to invest on foreign currency and on land and buildings because of political indefiniteness, so it seems very hard to turn savings into investments because of the infrastructure of the countries economic life.



3.4. Money Market

The obstacle in front of the transaction from savings to investment in the banking sector is the same as in Turkey. The first reason is the high interest rates, especially the high rates of legal reserves and the disponibility rate, that is increasing the cost of money. The level between the interest rates to the savings accounts and interest rates of credits is very high.

The high rates applied to the legal reserves decreases the liquidity risks of those banks which is being established with low level of paid capital and this creates a possibility for the public finance.

High capital owners generally invest into the banking sector so they get the opportunity and advantage of taking credits from their own banks at the low level of interests. The loans of the State Economical Enterprises are big problems to the banking sector, because those enterprises are not paying back the credits they get from the banks.

As a result, the structure of the banking sector is not sufficient to support small savings to turn into investment possibilities of the economy.

3.5. Incentives

For accomplishing the target of economic growth to achieve the economic and social needs and to speed up the foreign trade, for increasing the share of private sector in the economy, the scope of the incentives increased on industry, export and on tourism to attract foreign investors to the country.

Investment on tourism, education and health have the incentives like, paying 10% less on income tax for 5 years. Generally, the incentives are delaying the value added tax, 30% decrease on the credits for investment, free land for investment and custom (duty) free application. It is hard to say that the incentives are controlled efficiently and the important point is, it is very complicated to get any incentives because of the bureaucracy.

3.6. Social Security

The social security system with its social insurance, precautionary reserve, retirement fund and office of social services cover all the population. These systems are all congested because of the politics done in the past.

Expenditures of social security reached to 15% of the GNP. The rules of the social insurance system put some restrictions against the transfers from the public sector to private sector. If public workers want to make a transfer to the private

sector, they can not transfer their premiums from the retirement fund. Therefore, this situation creates difficulties to public workers to transfer into private sector for working if the economic circumstances are being better then public working. The contributions of the public to the social security funds are not sufficient so the problems in this field is getting bigger and bigger.

3.7. Agriculture

Lack of resources such as raw material and water cause restrictions to the industry that is depending on agriculture. The share of agriculture to total production except the service sector is 47% but only 5% of the total agricultural activities done by the use of water. The convenient area for the agricultural activities are very narrow.

The agricultural activities in those convenient areas are unproductive. 56.7% of the total area is for agriculture but economically agriculture is done in the 63% of this area. The watered or irrigation agriculture is done in the 8.4% of this area. The share of agriculture in the GNP was 19% in 1970 and this rate decreased to 10% in 1990. The investment for being more productive is not done in this sector. Those wrong agricultural politics are still goes on, a concrete example is, the government still give incentives to the products which does have a decreasing demand (eg. Grapefruit).

Agricultural sector constitutes the 20% of total employment. In 1982, compensation for drought started to applied for the aim of stabilising the agricultural income. In addition, the subventions for agricultural products create heavy weights on public budget. None of those increased the productivity level of production in this sector but guarantees the income of the producers. If all of those incentives used efficiently for increasing the productivity of the sector may cause an increase at the incomes of producers and most importantly increases the share of this sector's aid in to the economy.

3.8. Energy

Electricity production will cover the demand of the society until the year 2000. The infrastructure of the electric distribution system's tools needs to be repaired. Because this old system and the components can not carry the capacity at all and to many looses of electricity is happening.

In other words, the energy of electricity need to be repaired and new electricity power station must be constructed in the near future to achieve the demand. Turkey will solve water problem of TRNC in the near future.

3.9. International Trade

In the frame of European Community Court of Justice decisions, E.C countries put on application of 14% tax on the imports for the products of TRNC. The export of TRNC to E.C countries is restricted by this law. The exports to E.C countries was 36 million \$ in 1993, and this rate decreased to 25 million \$ in 1996. The exports to Turkey increased from 12.5 million \$ to 34.2 million \$, which equals to the half of total exports.

Doing activities in a country, which is not recognised in the international filed, may cause the costs to increase.

3.10. Tourism

Like as to the other economic fields, the insufficient investments on tourism and the public owned works on tourism are out of activities. Wrong incentives and tourism politics, lack of advertisement, organisation and especially unrecognition cause this sector to be undeveloped while it is the backbone of the economy.

Hotels which was constructed before 1974 did not being restorated again. Decrease on the amount of European tourists is seems and the tourist who spends less of foreign currency is increasing. This is because of the wrong politics on the tourism sector (except casino tourism). This developments show that the potential can not be use efficiently by the government.

4. PROPOSALS

Some reforms are needful to the government of TRNC to reorganise and to reconstruct the economy. First of all the important reform is to improve free-enterprise system, to decrease the share of public in the economy and to increase the activities of economy.

4.1. Structural Reforms

- For the aim of decreasing the deficit of the public, it is good to improve the control of taxation and decreasing the scale of the public in the economy is needful. If today's technology will be used, it won't be hard to prevent tax evasion in an economy like TRNC.
- Employment of the public side must not be increased and, if new personnel are needful, transfers between government offices must be done.
- The taxation system, which is a big obstacle in front of the economic development, must be reorganised, level of income tax and institutional tax must be decreased and must pass to inflation accounting system.
- Privatization must be speed up and to be enlarged for decreasing the share of public in the economy. Especially, electricity production and distribution is to be privatised as soon as possible depending on the capacity that is not cover the demand after the year 2000.

- Sectorial development is the tool of increasing the economic activities. Depending on this, investors from Turkey and TRNC must be attracted to the country by the system of build-work-transfer.
- Social security system, which will cover the differences between the public and private sector workers, must be developed. A worker of public may transfer his premium while transferring into private sector.
- Incentives of the agricultural production must be reorganised

4.2. Infrastructure and Preventive Measures for Sectorial Development

- Comprehensive works for feasibility and upon the results of those feasibilities, macro plans must be prepared for the investors for long time period of investment, on the service, agricultural and industrial sectors for investments. Depending on this frame work, detail feasibility works for the sectors which have enough competition power for production of electronic chips, software, high education, health, alternative tourism, flower production, luxury fruit & vegetable, fishing, fishing farms, trough production etc. must be prepared and put into application. Turkey must give support to those feasibility works if TRNC does not have enough opportunities. Those feasibility works must cover the field of human

resources for decreasing the amount of workers in the public and transferring them into the project that will support the economic activities.

- According to the results of feasibility works, if it is needful, some courses for educating some personnel to be specialist must be opened.
- The system of incentives must be reorganised according to the works of feasibility.
- In tourism sector, investments on infrastructure, human power, transportation and to increase alternatives of tourism filed must be done.
- A Tourism Management school must be open to cover the need of qualified personnel in tourism sector.
- Depending on potential of tourist, the airport and ports must be extended.
- Casino economy must be taken under control in near period, because in Turkey this sector is closed and seems to be getting bigger in TRNC.
- Infrastructures of the universities need investment for not to decrease the potential at hand. Departments of the universities must be increased to attract more student and open new fields for employment.
- Water problem of the country must be solved in near future, either by importing the water from Turkey or by the methods of saving water. Such as drop irrigation method in the orchid gardens must be supported and incentives is to be done by the government.

5. CONCLUSION

Basic principles lying under the economic problems of TRNC are the political problems. The increasing rate of economic problems, accordingly hesitations on economic and political problems of TRNC create a compulsory need for a negotiation of both sides (Turkish side and Greek side) to be equal. Otherwise, political and social problems will gain a dangerous weight.

Therefore, it seems very hard for TRNC to solve those problems with its own dynamics. In this case, Turkey has big liabilities and duties for solving such type of problems of TRNC.

Under the condition of reconstructing TRNC's economy, Turkish government and Turkish private sector must share their savings for investment with TRNC. Turkish government is supporting the economy with fiscal helps and commercial agreements. However, it is possible to use those helps more effectively and efficiently. This contribution or help may become more efficient if the investors from Turkey are given incentives to invest in TRNC.

However, decreasing public expenditures may cause economic and social problems to the society but it is possible to fill the places which was owned by the public by the private sector by taking out the tax and social security system that are the main obstacles against private investment.

TRNC economy has a big volume of private savings ratio, which is statistically proved. Nevertheless, the financial sector can not transfer those savings into investment and those savings are deposited in Turkey and England. If

the structural and political problems can be solved, these savings may be attracted to the country. If this is done, the investments in foreign countries may turn into savings to increase production.

The history lived by the TRNC implies that it is not possible to solve the political, social economical and cultural problems within its own dynamic. The helps and control of Turkey for a sustainable development is possible if this helps are mostly in the type of incentives for both foreign and domestic investors. The big deficit on public balance creates obstacles for the helps to turn into investment. Because government of TRNC prefers to use this helps for covering the public deficit.

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