



**NEAR EAST UNIVERSITY**

**INSTITUTE OF APPLIED  
AND SOCIAL SCIENCES**

**DEVELOPMENT STRATEGY  
FOR  
NORTHERN CYPRUS**

**Mustafa Gündüz**

**Master Thesis**

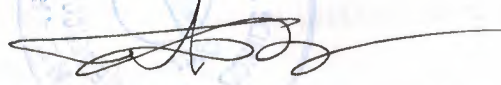
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Mustafa Gündüz: Development Strategy For Northern Cyprus

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We certify that this thesis is satisfactory for the award of a degree in  
Master in Economics

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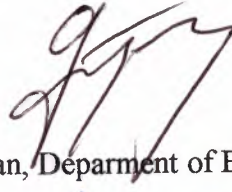
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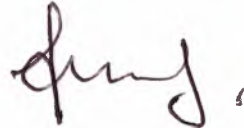
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## ABSTRACT

This thesis is devoted to introduce a development strategy for the TRNC. The political situation, the ambiguities and possible changes play an important role on the economic expectations and policy decisions in the TRNC.

The development strategy has a main assumption that, the negotiations between the leaders of the two communities will be successful. One 'Common Government' and two 'Component States' (the Turkish Component State of Cyprus in the north, and the Greek Component State of Cyprus in the south) will be established, according to the proposed plan by the UN Secretary General Mr. Kofi Annan. Another assumption is that, the settlement agreement will be applied very successfully and any the short-term social problems will be settled without any intercommunal trouble and the newly established common government of Cyprus will be a member of the EU.

The retrospective analysis of the TRNC economy is made in Chapter I. The analysis is based on statistical data from the 'Economic and Social Indicators' of the State Planning Organization of the TRNC Prime Ministry. The study was made in the year 2002 and the first chapter is closed on October 2002. The economic and social indicators of the year 2001 were not ready at that time. Therefore the retrospective analysis ends in the year 2000 in Chapter I.

Since the TRNC is a small island country and this thesis is aimed to introduce a development strategy for the TRNC, Chapter II is devoted to give short theoretical information about the Small Island Economies and the concept of development. The common characteristics of small island economies are discussed in this chapter.

Chapter III is devoted to examine the experiments of some countries, which were, developed in the second half of the twentieth century. Some lessons are derived from their experiments. These countries are, South Korea, Taiwan, Hong Kong, Singapore, Cyprus (later Southern Cyprus) and Ireland.



The development strategy is offered in Chapter IV. The strategy includes the organization of civil services, government policies (monetary, fiscal, budgetary, structural and sectoral policies).

**Abbreviations**

CAP	Common Agricultural Policy of EU
CFP	Common Fishery Policy of EU
CM	Common Market
CTO	Cyprus Tourism Organization
CU	Customs Union
EDB	Economic Development Board
EEAP	Emergency Economic Action Plan
EMU	Economic and Monetary Union
EPZ	Export Process Zones
ERDF	European Regional Development Fund
ESF	European Social Fund
ETC	European Travel Commission
EU	European Union
FDI	Foreign Direct Investment
FTA	Free Trade Area
FYDP	Five Years Development Plan
GATT	General Agreement on Tariffs and Trade
GNP	Gross National Product
ITRI	Industrial Technology Research Institute
NIC	Newly Industrialized Countries
SBIP	Science Based Industrial Park
SIDS	Small Island Developing States
SPO	State Planning Organization
TL	Turkish Lira
TR	Turkey
TRNC	Turkish Republic of Northern Cyprus
UK	United Kingdom
UN	United Nations
USD	United States Dollar
WTO	World Trade Organization

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## INTRODUCTION

The aim of this thesis is to introduce a development strategy for northern Cyprus. The political situation of the TRNC that is the unsettlement, embargoes and isolation play an important role on the TRNC economy. The negotiations for the settlement of the Cyprus problem, between two communities have been continuing for many years. The unsettlement of the problem has no negative effect on the economic development of South Cyprus except high defense expenditures. Therefore the TRNC has to find a way for her economic development by taking into account the possible political changes in the short and long runs.

The hypothesis of this thesis is; the economic development of TRNC is possible by applying a clever development strategy. The strategy has to take into account the possible political changes of the current situation. The development strategy has to take into account certain assumptions about the ongoing political negotiations between the two communities. These assumptions have to be considered as the starting point of the strategy. Then, by examining the situations of each sector separately analyzing the dynamic advantages and threads of each sector, introducing a separate development pattern for each sector also introducing macroeconomic and structural policies an economic development strategy could be established.

There is no unique way of increasing the richness of a country. Every country has to take into account their opportunities and threats in the global world market and also has to use their internal strength and also has to overcome its weaknesses. The non-settlement of the Cyprus problem hence the embargoes and non-recognition of the TRNC are external weaknesses of the TRNC. A clever economic development strategy overcomes these weaknesses.

An economic development strategy is the total methodology and planning for the economic development of a country. It is a dynamic process, which controls and corrects itself. The economic development means the increase in wealth and the welfare of the individuals in the economy. The growth in per capita income of the country does not mean economic development. The decrease in poverty and unemployment and also the decrease in the income gap between the high and low-income groups are important.



In this thesis, the retrospective analysis of the TRNC economy is made in order to find out the basic factors of the unsatisfactory development of the TRNC. The retrospective analysis of each sectors are made separately. This helped to find out the strengths and weaknesses of each sectors individually. The retrospective analysis of the TRNC economy is based on the statistical data and the Economic and Social Indicators 2000 of the State Planning Organization of the TRNC Prime Ministry.

The TRNC is a small island economy. Therefore the common characteristics of small island economies introduced and the implications of these characteristics on TRNC economy are discussed in this thesis.

The experiments of some recently developed countries are studied. The selected countries are the recently developed countries, namely in the second half of the twentieth century. Also the selected countries are relatively small economies. The experiment of South Cyprus is examined because the TRNC is on the same island and after the settlement the two economies will be integrated. The development of Ireland is also examined because the development of Ireland took place after the accession to the EU. The analysis of the development experiments of the selected countries is based on the published data about these countries. No interviews with the economic bureaucrats and technocrats were made.

The main assumption of the introduced development strategy is that the settlement negotiations between the leaders of two communities will be successful. A 'Common Government' and two 'Component States' (The Turkish Component State in the north, and the Greek Component State of Cyprus in the south) will be established according to the proposed plan by the UN Secretary General Mr. Kofi Annan. The second assumption of this thesis is that there will be no serious intercommunal troubles and social problems during the realization of the settlement agreement. Also, as it is mentioned in the proposed Annan plan, the newly established Common Government of Cyprus will be a member of the EU. If it will not become possible to achieve a settlement through the proposed Annan plan, then the introduced development strategy of this thesis will not be applicable. If this happens revision in the development strategy



has to take place for the unsettled situation of Cyprus and the accession of South Cyprus to the EU. At the end of the fourth chapter a revision section is put for this purpose.

CHAPTER I

The introduced strategy takes into account the iterative integration processes between the North Cyprus and the South Cyprus economies, and the integration of the whole Cyprus economy with the European Economy. The strategy offers new organization of the economic civil administration of the TRNC. Also the strategy offers new macroeconomic and structural policies for the TRNC. Finally the strategy offers new development patterns for the main sectors of the TRNC.

# CHAPTER I

## THE RETROSPECTIVE ANALYSIS OF THE TRNC ECONOMY

## 1.1 History Of TRNC

There have been a lot of political changes in the history of Cyprus. These political changes created changes in the economic structure of the island. After controlling more than three centuries, the Ottoman Empire rented Cyprus to Great Britain in 1878. After the First World War, Cyprus became a crown colony of Great Britain.

In the 1950s, struggles against colony regime started. In those days more than 95% of the population was made up of Turks (Approx 20%) and Greeks (Approx. 76%). The aim of Greek Cypriots fighting against the colony regime was to join Cyprus to their motherland Greece, while the aim of Turkish Cypriots was to divide Cyprus into two parts and join the northern part to their motherland Turkey and leave the southern part to Greek Cypriots. The two communities never fought together against the colony regime.

In the year 1960 Great Britain agreed to leave Cyprus. Turkey, Greece and Great Britain agreed to establish a new government in Cyprus, namely Republic of Cyprus<sup>1</sup>. Republic of Cyprus was a functional federation where Turkish Cypriots were represented by 30% and Greek Cypriots were represented by 70% in the administration.

The life of this republic lasted three years. In the year 1963 struggles between the Turkish and Greek Cypriots started. Turks expelled out from the government. Turkish Cypriots were forced to leave mixed settlements and other small Turkish villages. Between 1963 and 1974 Turkish Cypriots were forced to live in the separated small towns (Totally about 5% territory of the island). The borders of these towns surrounded by Greek Cypriots. Starting from the year 1964, the 'Republic of Cyprus'. 100% of which was represented by Greek Cypriots, was recognized by other countries as Republic of Cyprus.

In 1974, with the help of Greece, Greek Cypriots tried to change the political regime of Cyprus and join the island to Greece.<sup>2</sup> Turkey sent military forces to Cyprus

<sup>1</sup> 15 August 1960, The declaration of independence of the Republic of Cyprus

<sup>2</sup> 15 July 1974, The army of the Republic of Cyprus changed the government by force



and Cyprus was effectively divided into two parts.<sup>3</sup> Two communities were separated from each other. The northern part of Cyprus (Approx 34% of the island) became the Turkish side of Cyprus, in which Turkish Cypriot administration established. Afterwards this administration declared itself as a separate republic in the island; namely Turkish Republic of Northern Cyprus (TRNC), but only the motherland Turkey recognized it.

Today, the TRNC is the government of Northern Cyprus, which is not recognized by any other countries except motherland Turkey. There are Greek embargoes against the TRNC. Although the government of south Cyprus 'Republic of Cyprus' does not fulfill the agreements of 1960, it is accepted by all countries of the world (except Turkey) as the government of whole Cyprus. The 'Republic of Cyprus' represents Cyprus in the United Nations and other international institutions.

The 'Republic of Cyprus' applied for the membership of the EU as the representative of the whole Cyprus and the accession negotiations expected to be completed in the year 2002. The EU declared that, whether or not the final settlement in Cyprus is achieved, the EU will accept the 'Republic of Cyprus' as a member.

Turkey is also accepted, as a candidate to the EU but the accession negotiations haven't started yet. The Turkish Parliament has passed on numerous legislation to date in parallel with the EU criteria.

## **1.2 The Economic History of Turkish Cypriots**

When the Ottoman Empire conquered Cyprus, Turkish population transferred from Anatolia to the island. Those people constitute the origins of the Turkish Cypriots. In the period of the Ottoman Empire, Turks were the landowners and the main economic activities were agriculture and the production of the related tools and equipments and repair.<sup>4</sup>

<sup>3</sup> 20 July 1974 Turkish Peacekeeping Operation

<sup>4</sup> Mustafa Necati Sepetçioğlu, Sabir Ağacı, C.V, İstanbul, Kuşak Ofset Matbaası, s. 150 - 160



Under the British Colonial Administration, trading and business activities passed to Greek Cypriots. Many of the Turkish Cypriots sold their lands to Greek Cypriots.

In the years of the Republic of Cyprus (1960 – 1963) the economic activities carried out mainly by Greek Cypriots. Exports, imports, industrial production and tourism were under the control of Greek Cypriot companies. Turkish Cypriots were doing only secondary businesses that buying goods from Greek Cypriot wholesalers and selling to Turkish Community. Turkish Cypriots were mainly engaging in the agricultural production and they were selling their products to the Greek Cypriot wholesalers and exporters. Tourism was under the control of Greek Cypriot companies and their joint ventures. Turkish Cypriot tourism companies were selling travel tickets to the Turkish Community.

The years between 1963 and 1974 were the dark years for Turkish Cypriots. Especially in the years between 1963 and 1968 Turkish Cypriots fought for survival. In those years, Turkish Cypriots survived with the aids coming from motherland Turkey.<sup>5</sup> After 1968 the blockades around the Turkish towns were released. Then, Turkish Cypriots able to sell their agricultural products to the Greek Cypriot wholesalers and exporters and also Turkish Cypriot buyers in bigger towns. On the other hand, Turkish Cypriots were buying imported goods from the Greek Cypriot importers and other products from Greek Cypriot industrialists and selling them in Turkish towns. Starting from the 1950s, small production units (especially textile and food production) were established by some Turkish Cypriot enterpreneurs.

Between 1963 and 1974, the 'Republic of Cyprus' functioned as a Greek Cypriot Republic and all the investments and developmental programs applied to the Greek parts. In particular they made programmed investments on tourism and related industries. Greek Cypriots and their joint ventures built big hotels in Kyrenia, Varosha, Famagusta and Limasol. The international transportation completely controlled by the Greek Cypriot companies. The airport and the seaports were in the Greek hands.

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<sup>5</sup> M. Sami Denker, **Kıbrıs Sorunu**, Türk Metal Sendikası yayınları, 2001, s.45 - 48

After the military operation of Turkey, the Turkish Cypriots were gathered in the northern part of Cyprus where controlled by Turkish troops. Turkish Cypriots established their own administrative authority in the north (TRNC). The Greek Cypriots wealth in Northern Cyprus, factories and Famagusta port were left to the Turkish Cypriots. TRNC established its own economic policy for development of Northern Cyprus, but always under the pressure of two constraints namely embargoes and non-recognition.

The aim of this thesis is to examine economic structure of the TRNC and offer economic development strategy for TRNC.

**Table 1.1 GNP of the TRNC 1977 – 2000**

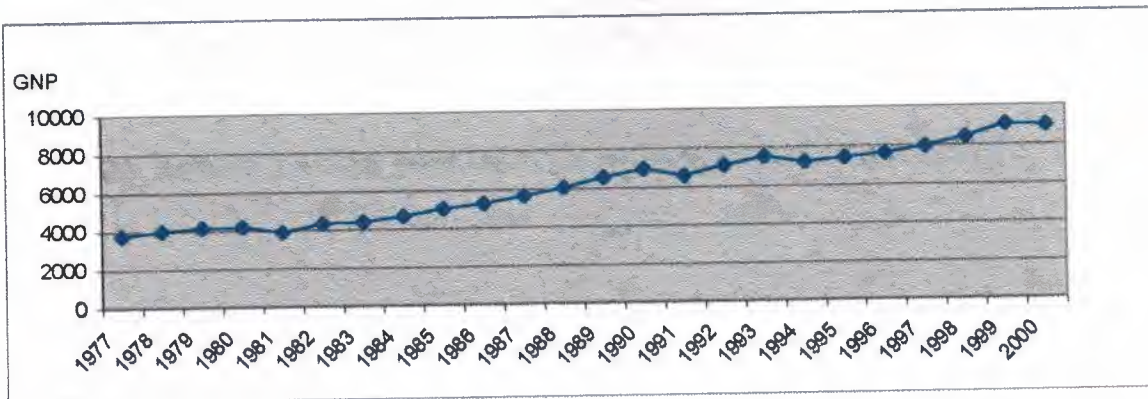
YIL	GNP 1977 PRC Million TL	GNP Million USD	GNP PER CAPITA 1977 Prs TL	GNP PER CAPITA USD	GROWTH RATE %
1977	3810,5	209,4	26279	1444	
1978	4031,5	214,7	27472	1463	5,8
1979	4210,1	231,1	28351	1556	4,4
1980	4248,4	233,6	28396	1561	0,9
1981	3929,8	217	25985	1335	-7,5
1982	4369,5	208,5	28430	1361	11,2
1983	4440,4	202,9	28552	1305	1,6
1984	4725,2	201,2	29909	1274	6,4
1985	5080,4	240,2	31696	1498	7,5
1986	5324,1	285,9	32728	1757	4,8
1987	5684,1	331,6	34442	2009	6,8
1988	6084	341,7	36375	2043	7
1989	6603	425,4	39008	2513	8,5
1990	6977,4	591	40692	3447	5,7
1991	6606,4	541,4	38021	3116	-5,3
1992	7124,7	585,5	40685	3343	7,8
1993	7547,4	624,9	42612	3528	5,9
1994	7268,3	554,3	40558	3093	-3,7
1995	7457,8	755,7	41121	4167	2,6
1996	7673,4	773,9	41865	4222	2,9
1997	7990,4	759,8	39573	3763	4,1
1998	8468,1	890,5	41465	4361	6
1999	9090,8	963,9	44010	4666	7,4
2000	9037,9	1039,9	43267	4978	-0,6

Source: TRNC Prime Ministry, SPO, Economic and Social Indicators, 2000

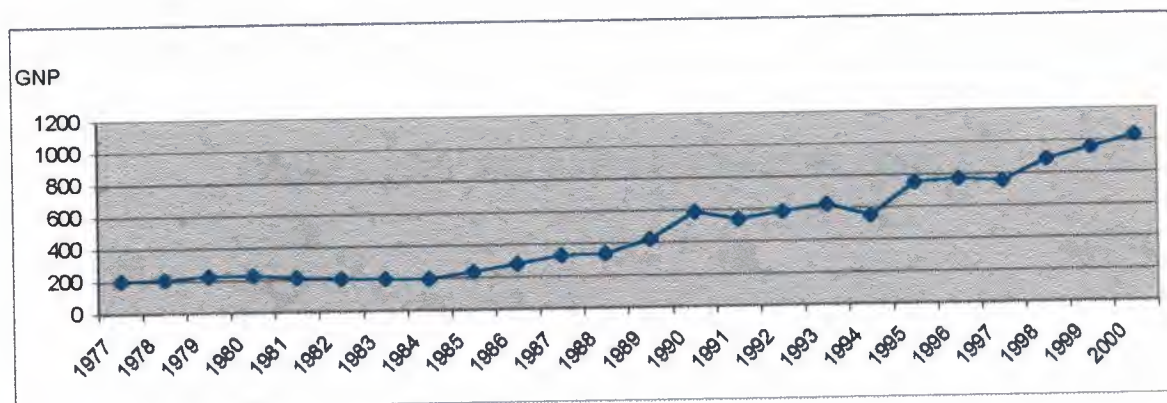


### 1.3 Analysis of Economic and Social Indicators of the TRNC

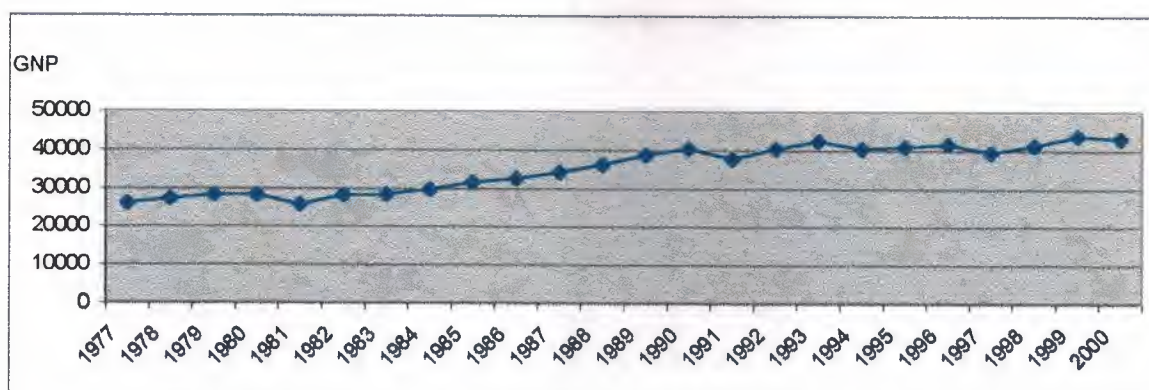
The economic indicators concerning TRNC are the published data of the State Planning Organization (SPO) of TRNC Prime Ministry. There aren't any written data for the years between 1974 and 1977. The retrospective analysis of the TRNC economy based on the data of the years between 1977 and 2000 published by SPO.



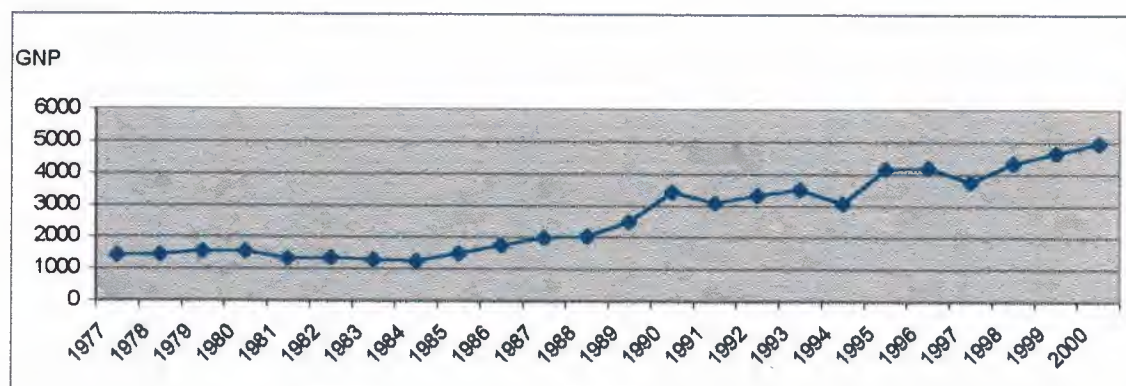
**Graph: 1.1 GNP of the TRNC (1977 Prices Millions)**



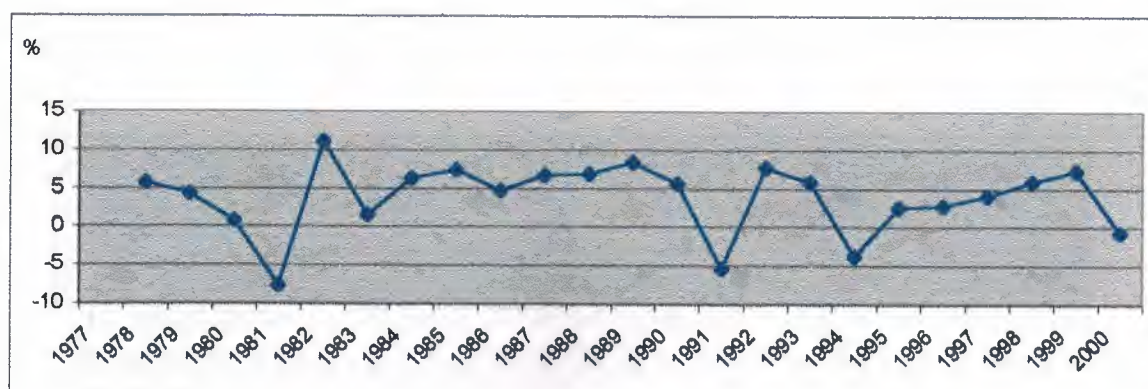
**Graph: 1.2 GNP of the TRNC (Million USD)**



**Graph: 1.3 GNP PER CAPITA of the TRNC (1977 prices TL)**



**Graph: 1.4 GNP PER CAPITA of the TRNC (USD)**



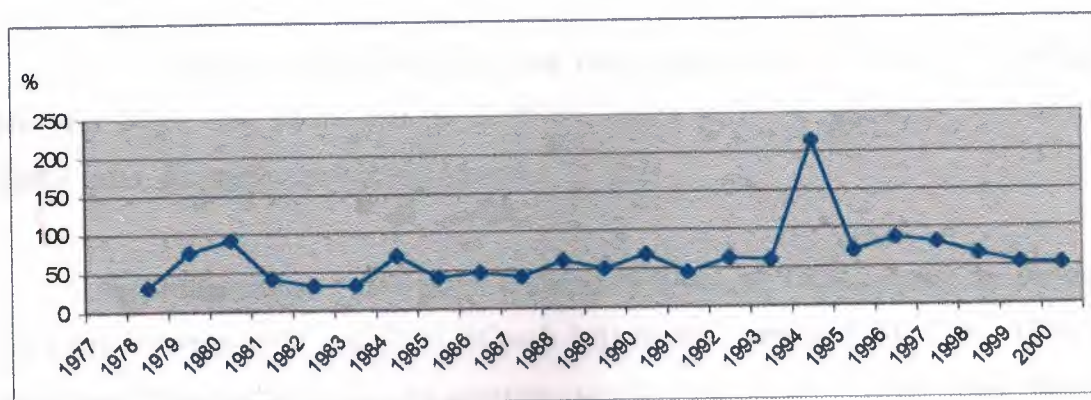
**Graph: 1.5 Growth Rate of the TRNC (%)**



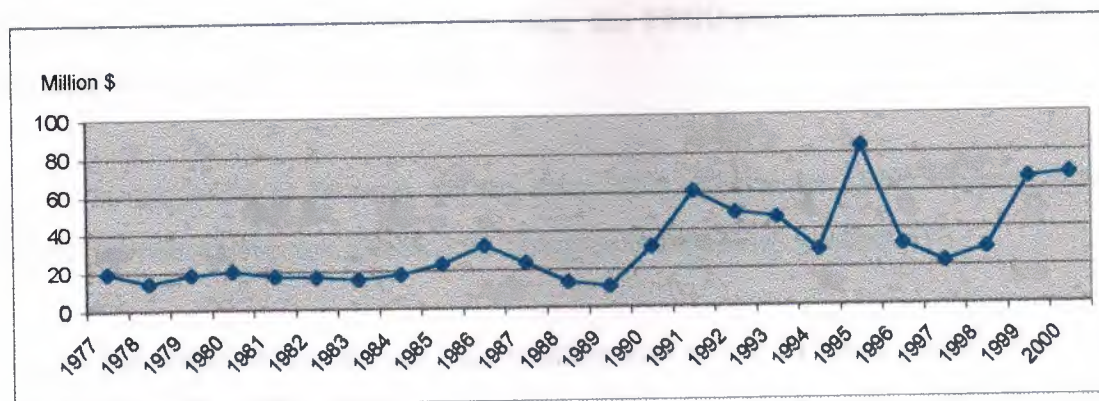
Table 1.2 Economic Indicators of the TRNC

YEAR	INFLATION RATE	BUDGET DEFICIT Million \$	BANK DEPOSITS Million \$	FORING EXCHANGE RESERVES Million \$
1977		20	93,4	2,4
1978	32,4	14,8	95,2	6
1979	77,7	19,1	67	4,6
1980	93	20,9	45,9	5,7
1981	42,8	17,9	48,9	13,8
1982	33,2	17,4	53,4	18,6
1983	33,8	16,1	59,9	27,9
1984	70,7	18,5	69,1	41,6
1985	43	23,7	88,2	61,3
1986	48,1	33,1	121,2	83,5
1987	43	24,2	174,5	116
1988	62,6	13,6	177,8	149,7
1989	51,8	11,3	234,9	183,2
1990	69,4	31,9	277,6	183,7
1991	46,3	60,8	295,8	217,8
1992	63,4	49,5	355,3	233,9
1993	61,2	46,7	436,4	301,9
1994	215	29,4	426	348,9
1995	72,2	83,7	499,8	417,8
1996	87,5	32	581,3	513,8
1997	81,7	22,6	659,1	510
1998	66,5	29,6	735,7	622,3
1999	55,3	66,6	837,2	654,4
2000	53,2	68,6	920,3	631,9

Source: TRNC Prime Ministry, SPO, Economic and Social Indicators, 2000



Graph 1.6 Inflation Rate of the TRNC (%)



**Graph: 1.7 Budget Deficit of the TRNC (Million USD) on USD)**

### 1.3.1. Analysis of GNP, Growth and Inflation of TRNC<sup>6</sup>

The GNP of TRNC was 3810.5 million in the year 1977 and it became to 9037.9 million TL in the year 2000, with the constant prices of 1977. During the period of 24 years from 1977 to 2000 the GNP of TRNC increased 2.37 times with the prices of 1977. (Table 1.1)

If we examine the GNP on USD basis then in the year 1977, the GNP of the TRNC was 209.4 million dollars and it became 1039.9 million dollars by the year 2000, after 24 years. This means that GNP of TRNC increased 4.95 times during this period. (Table1.1)

GNP per capita with the 1977 prices was 26279 TL in the year 1977 and it became 43267 TL in the year 2000, which means that the GNP per capita of TRNC increased only 1.64 times with 1977 prices, during this period. (Table 1.1)

The GDP per capita on dollars was 1444 dollars and it became 4978 dollars in the year 2000. This means that the GNP per capita of TRNC increased 3.44 times in dollar basis, during the period of 24 years.

Great fluctuations took place in the growth rate of TRNC during the period of 24 years between 1977 and 2000. (Graph 1.5) In the years of 1981, 1991, 1994 and 2000 the TRNC economy showed negative growth. These years were the crisis years of

<sup>6</sup> TRNC Prime Ministry, SPO, **Economic and Social Indicators 2000**, p. 2-3



the Turkish economy. When there was recession in Turkey, the economy of the TRNC also had recession. This analysis shows that, the TRNC economy is directly linked to the Turkish economy.

In the period of 24 years starting from 1977 to 2000 the TRNC economy grew 3.75% per year on average. (Table 1.1) The growth rate is not satisfactory.

The TRNC economy had high inflation rate in the 24 years period of 1977 – 2000. During this period the inflation of the TRNC never had a single digit level. It was always at two digits and in the band of 50% - 90%. The lowest inflation of this period was 32.4% at the beginning of the period in the year 1978. the TRNC had galloping in the year 1994 with the level of 215% (Table 1.2)<sup>7</sup>

The TRNC economy was always under the pressure of four basic factors, namely:

- i- Effects of external economic factors
- ii- Effects of political situation of TRNC
- iii- Effects of internal economic structure
- iv- Effects of size of the economy (Small island economy)

The effects of the above factors on the economy of the TRNC will be explained during the analysis of the economic indicators of the TRNC. The effects of external economic factors are explained below.

#### **1.3.1.1 Effects of External Economic Factors on the TRNC Economy**

The main external factor, which affects the economy of the TRNC, is the Turkish economy. Turkey (TR) and TRNC are using the same monetary unit, namely Turkish Lira (TL). Therefore the TRNC economy is directly related to the Turkish economy. Although TR and TRNC are using the same monetary unit, they don't have an economic union between each other. The economies of the two countries (TR and TRNC) are organized as two separate economies, which have the same monetary unit in circulation. This is a unique kind of integration, with negative effects to the small

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<sup>7</sup> Ibid.

economy, namely TRNC economy. The theory of the levels of economic integrations is examined below.<sup>8</sup>

#### Free Trade Area (FTA)

Member countries abolish tariffs or quotas on trade among themselves, but they are free to determine tariffs and quotas on non-member countries.

#### Customs Union (CU)

In addition to FTA member countries apply common tariffs and quotas on imports from non-member countries.

#### Common Market (CM)

Besides the free movement of goods and services among the countries within the customs union, member countries have free movement of labor and capital and companies.

#### Economic Union (EU)

Further to the common market level of integration, member countries have common macroeconomic policies, such as common agricultural, industrial, competition, environment, transportation, regional policies but not common monetary policy.

#### Economic and Monetary Union (EMU)

This is the highest level of economic integration where member countries have common monetary policy besides other macroeconomic policies. They have a single currency and a central bank, and member states become regions within the union.

In the TRNC the monetary unit of Turkey TL is circulating but there is no unification, (any kind of integration) between TR and TRNC. Two countries do not apply the same macroeconomic policies. In other words, although the TRNC uses TL, she does not follow the same fiscal policies as the TR and she has some differences and time lags in the application of monetary policies.

<sup>8</sup> Ahmet Z. Bulunç, **Ekonomik Bütünleşmenin Tanımı, Türleri ve Amaçları**, Yayınlanmamış Doktora Tezi, Uludağ Üniversitesi, Bursa 2000, s.7 – 14.



TRNC imports from TR the basic macroeconomic indicators, such as, interest rates, exchange rates, and inflation; because the TRNC has the same currency of TR. TRNC has no chance to balance these basic macroeconomic indicators but accepts them as given by Turkey.

On the other hand, because of the big gap of public income and expenditure, and because of the closed and small (without any deepness) economy, the TRNC has her own inflation. This inflation is added on top of the inflation imported from Turkey. Therefore the inflation level of TRNC is higher than the inflation level of Turkey.

Turkey and TRNC are using a common currency but they don't have an economic union between each other, therefore the factors of production and the products do not move freely in between them. Since the TRNC has a higher inflation level than Turkey (because the TRNC's inflation is added on top of the inflation of Turkey) and since Turkey and TRNC has the same exchange rates, the value of TL in TRNC is higher than the value of the TL in Turkey. The phenomenon is explained below:

In the period of January – August 2001 the inflation in Turkey was 39.0% and in TRNC the inflation was 53.24%<sup>9</sup>. The difference 14.24% is the self-inflation of the TRNC. On the other hand, the two countries had the same exchange rates. Therefore, in the TRNC with the same exchange of one dollar, fewer amounts of goods and services than Turkey could be obtained. This means overvalued TL in TRNC. This has a negative effect on the production, exports, and tourism of TRNC.

During the period of 24 years (1977 – 1999) the Turkish economy had several crises. These crises had multiplying effects on the TRNC economy. Turkish governments had applied several shock programs to the Turkish economy in order to overcome the crisis. On the other hand the TRNC governments didn't apply similar programs to their economy. They proffered to wait without doing anything until the crisis in Turkey to pass. This harmed the economy of the TRNC. Similar economic programs were prepared under the pressure of Turkish Republics for the TRNC

<sup>9</sup> TRNC Prime Ministry, SPO, Inflation Rates of TRNC year 2001

economy but the TRNC governments usually didn't apply them as a whole. This also had harmful effects on the TRNC economy

### **1.3.1.2 Effects Of The Political Situation of TRNC**

Since the military operation of Turkey in 1974, no political solution has been reached in Cyprus. Therefore the military situation of Cyprus is a form of "ceasefire" period starting from 1974 and still continuing.

The Greek administration in South Cyprus is recognized by all countries of the world (except Turkey) as the legal representative of whole Cyprus, with the name of 'Cyprus Republic'. TRNC is not recognized as a separate authority on the island by any other countries except the motherland Turkey.

As a result of the pressures of Greece and 'Republic of Cyprus' all the countries of the world (except Turkey) are applying embargoes to TRNC. This embargoes and the isolations of the TRNC put barriers on the exports and tourism of TRNC. Also increase the transportation costs on international business. Therefore the political situation of TRNC has negative pressure on the economic development of the TRNC.

### **1.3.1.3 Effects Of Internal Economic Structure**

The public sector of TRNC is very huge compared the size of the economy of TRNC. The civil services are overcrowded. Therefore the government expenditures are very high. In the year 2000 total personnel employed by the by the governmental institutions were 22273 persons.<sup>10</sup>

*The civil servants obtained the opportunity to retire at very young ages. The social security gap between civil servants and private sector employees is terribly wide. As a result of this the elasticity of the labor market of TRNC is lost. The social security system of TRNC has collapsed.*

<sup>10</sup> TRNC Prime Ministry, SPO, Statistical Yearbook 2000, pp. 135



The above structure of the public administration of TRNC increases the budget deficits of TRNC. The budget deficits of the TRNC are shown in the Graph 1.7<sup>11</sup>. This puts negative pressure on the production of TRNC, hence the increased costs of TRNC products.

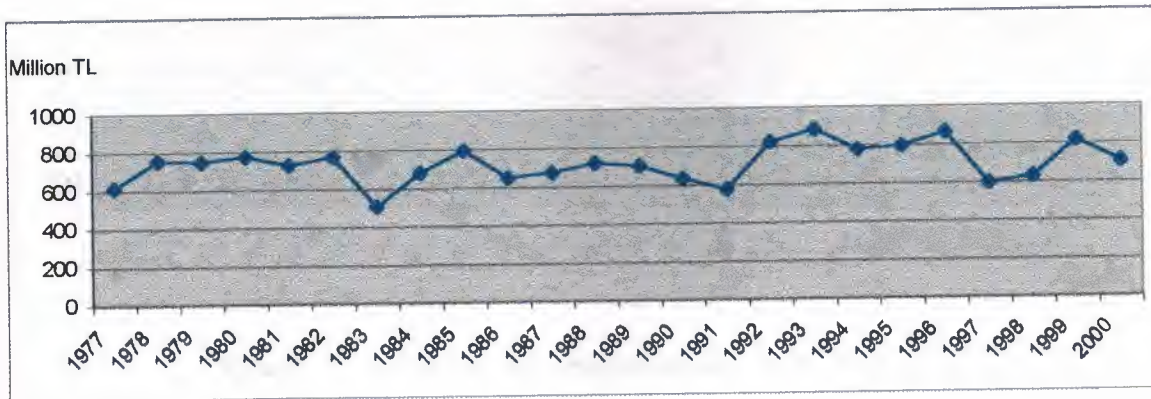
TRNC economy is a small island economy. Therefore the smallness and isolations puts barriers against the capital concentration and economic development. The characteristics of small island economies are studied in Chapter II.

**Table: 1.3 Indicators of Sectoral Developments (1977 prices million TL)**

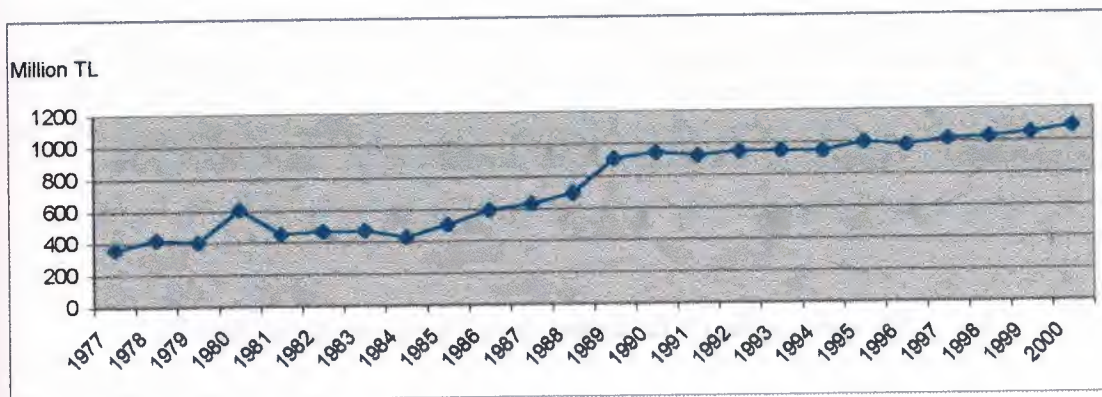
YEAR	AGRICULTURE	INDUSTRY	TOURISM	TRADE	CONSTRUCTION	TRANSPORT COMMUNICATION
1977	619,3	365,1	99,7	701,3	153	257,4
1978	757,7	426,5	116,6	673	160,3	293,5
1979	752,7	409,5	143,3	667,4	171,7	317,7
1980	779,5	612,7	114,4	656,5	135,7	285
1981	732,5	458,6	54,8	610,2	170,7	278
1982	772,5	475,5	95,6	755,4	202,7	375,7
1983	512,3	478,1	58,7	817,9	208,8	481,8
1984	686	435,2	74,1	824,9	270,4	485,2
1985	801	510,8	80,9	876,4	263,8	474,5
1986	655,2	600	92,9	887,3	366,5	574,8
1987	677,9	634,4	112,9	933,4	451,3	610
1988	726,7	700,1	136,6	950,8	465,6	694,6
1989	709,1	912,3	140,7	1066,3	501,3	753,8
1990	639,7	947,3	160,9	1173,2	506,3	791,8
1991	580,4	925,3	125,8	1073,9	540,1	675,3
1992	827	949,7	178,2	1079,2	655,2	688,5
1993	891,1	953,6	221,9	1083,9	704,7	746,8
1994	781,1	952,8	235	1023,5	646,7	762
1995	799,8	1001,6	243,6	1149	507,5	812,4
1996	870,8	982,2	210,9	1033,6	523,3	856,9
1997	601	1017,7	241,7	1076,2	647,5	937,3
1998	636,2	1029,6	249,5	1201,4	694,6	974,6
1999	822	1054,2	277,8	1280,9	708,6	1043,3
2000	713,5	1096	288,2	1186,4	841,4	1113,5

Source: TRNC Prime Ministry, SPO, Economic and Social Indicators 2000

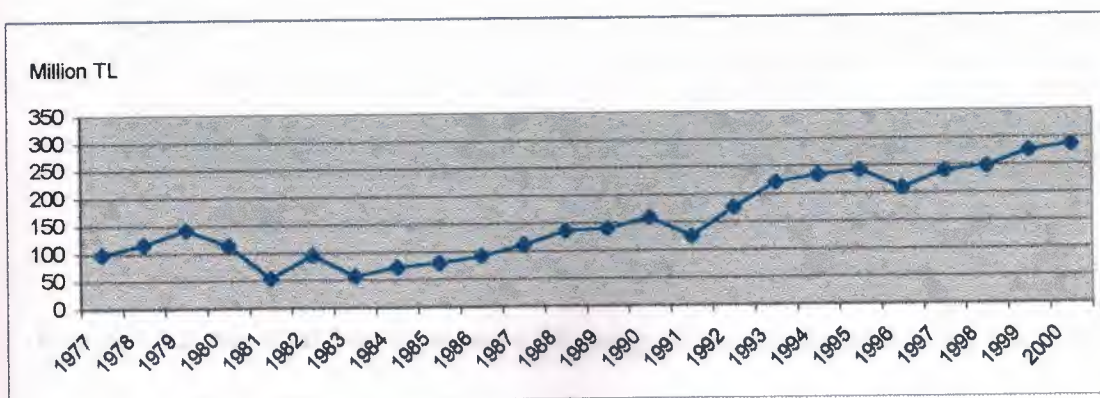
<sup>11</sup> TRNC Prime Ministry, SPO, *op. cit.*, pp. 2-3



**Graph 1.8: Sectoral Development of Agriculture (1977 prc)**

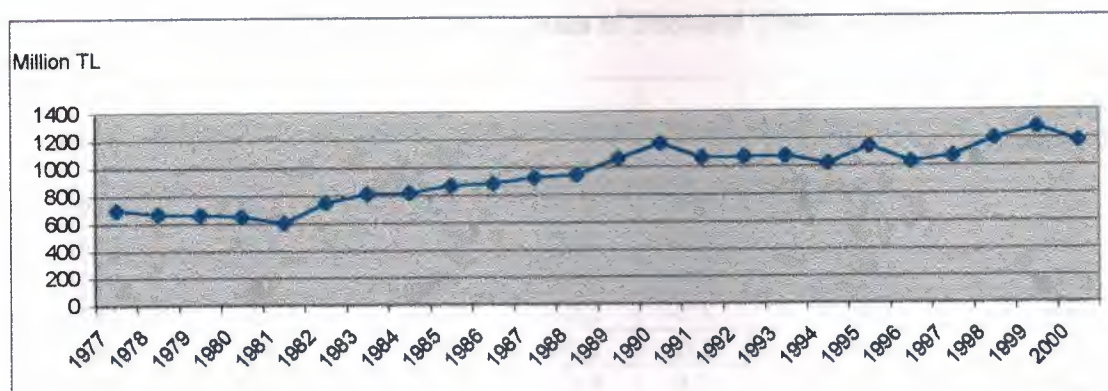


**Graph 1.9: Sectoral Development of Industry (1977 prc)**

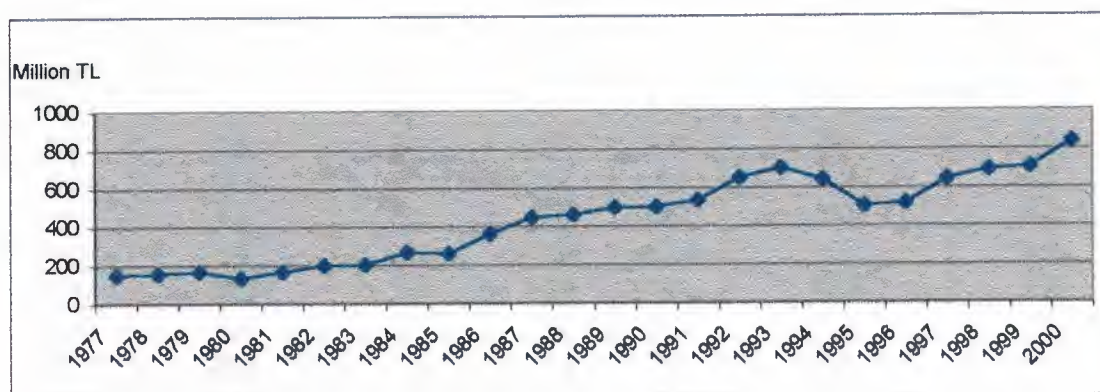


**Graph 1.10: Sectoral Development of Tourism (1977 prc)**

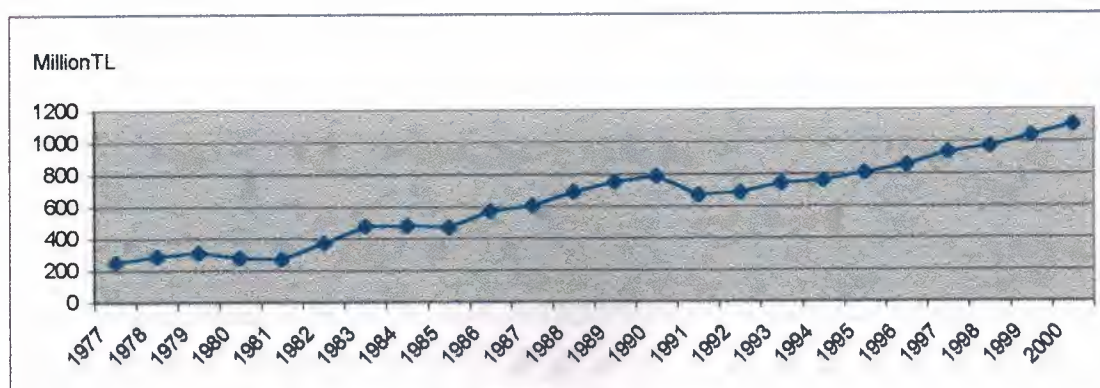




**Graph 1.11: Sectoral Development of Trade (1977 prc)**



**Graph 1.12: Sectoral Development of Construction (1977 prc)**

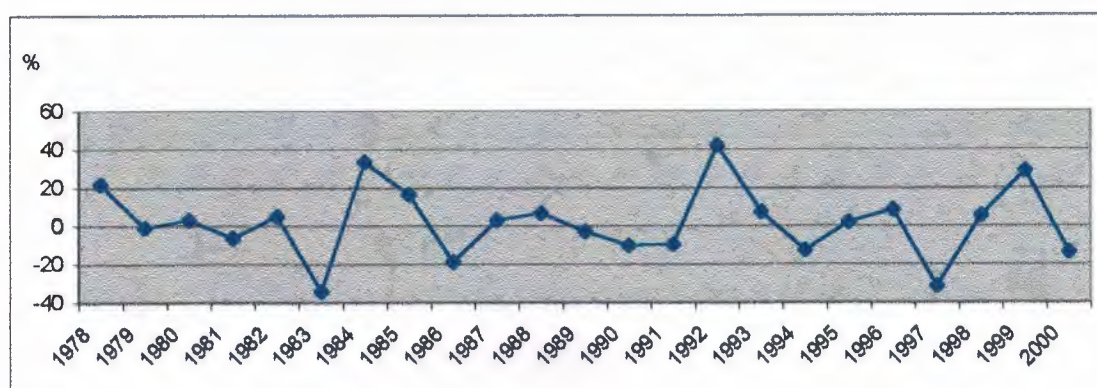


**Graph 1.13: Sectoral Development of Transport and Communication (1977 prc)**

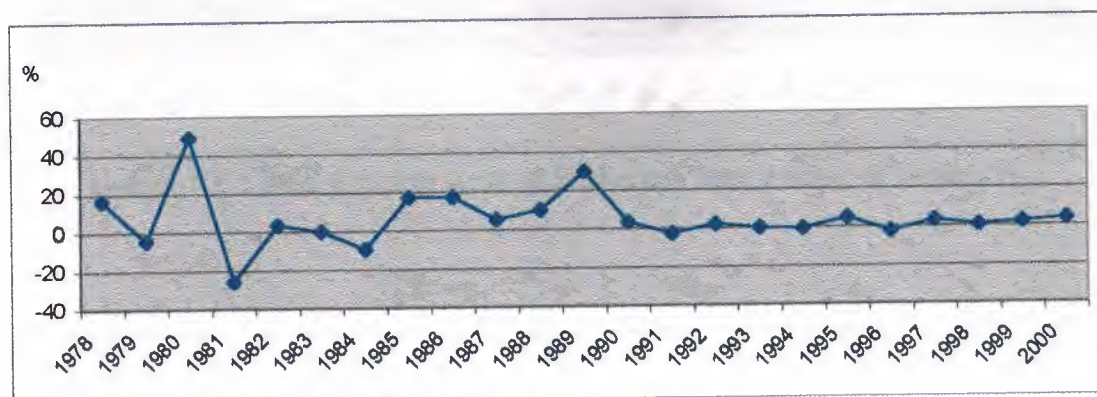
**Table: 1.4 Real Growth Rates of Sectoral Value Added (%)**

YEAR	AGRICULTURE	INDUSTRY	TOURISM	TRADE	CONSTRUCTION	TRANSPORT COMMUNIC.
1978	22,3	16,8	17,0	-4,0	4,8	14,0
1979	-0,7	-4,0	22,9	-0,8	7,1	8,2
1980	3,5	49,6	-20,2	-1,6	-21,0	-10,3
1981	-6	-25,2	-52,1	-7,1	25,8	-2,5
1982	5,5	3,7	74,5	23,8	18,7	35,9
1983	-33,7	0,5	-38,8	8,3	3,0	28,2
1984	33,9	-9,0	26,7	0,9	29,5	0,7
1985	16,8	17,4	9,2	6,2	-2,4	-2,2
1986	-18,2	17,5	14,8	1,2	38,9	21,1
1987	3,5	5,7	21,5	5,2	23,1	6,1
1988	7,2	10,4	21,0	1,9	3,2	13,9
1989	-2,4	30,3	3,0	12,1	7,7	8,5
1990	-9,8	3,8	14,4	10,0	1,0	5,0
1991	-9,3	-2,3	-21,8	-8,5	6,6	-14,7
1992	42,5	2,6	41,7	0,5	21,3	2,0
1993	7,8	0,4	24,5	0,4	7,6	8,5
1994	-12,3	-0,1	5,9	-5,6	-8,4	2,0
1995	2,4	5,1	3,7	12,3	-21,5	6,6
1996	8,9	-1,9	-13,4	-10,0	3,1	5,5
1997	-31,0	3,6	14,6	4,1	23,7	9,4
1998	5,9	1,2	3,2	11,6	7,3	4,0
1999	29,2	2,4	11,3	6,6	2,0	7,0
2000	-13,2	4	3,7	-7,4	18,7	6,7

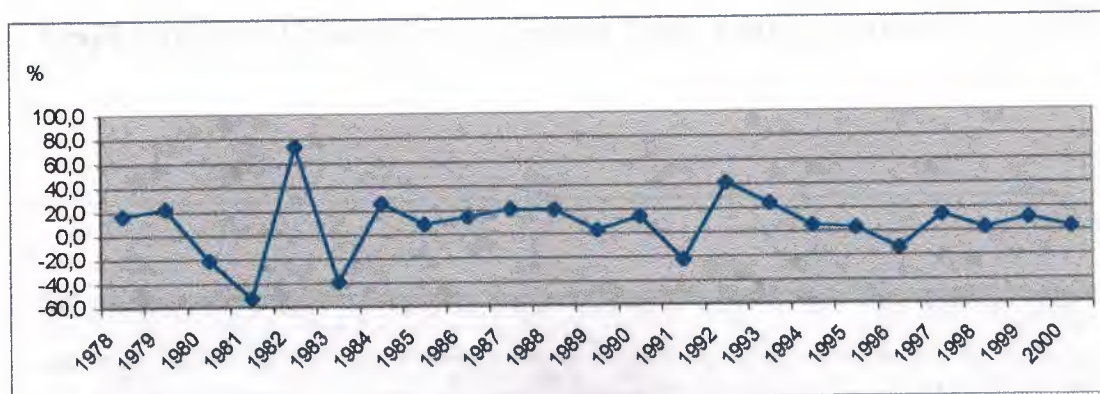
Source: TRNC Prime Ministry, SPO, Economic and Social Indicators 2000

**Graph 1.14: Real Growth Rate of Sectoral Value Added of Agriculture (%)**

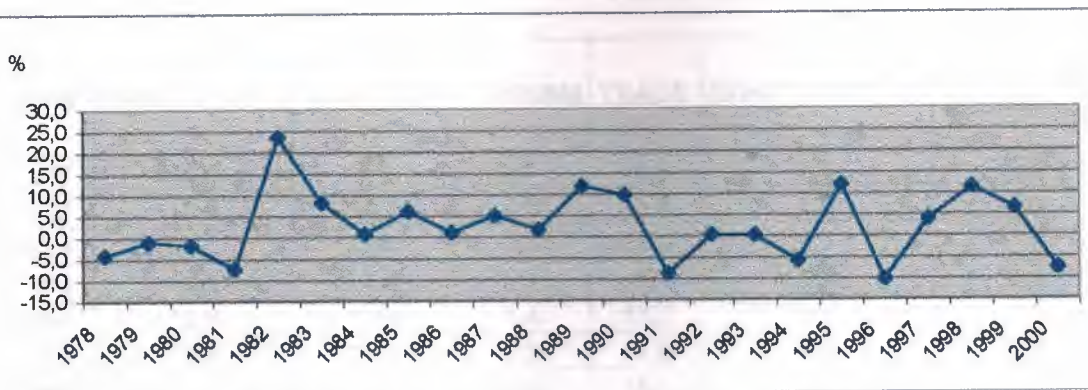




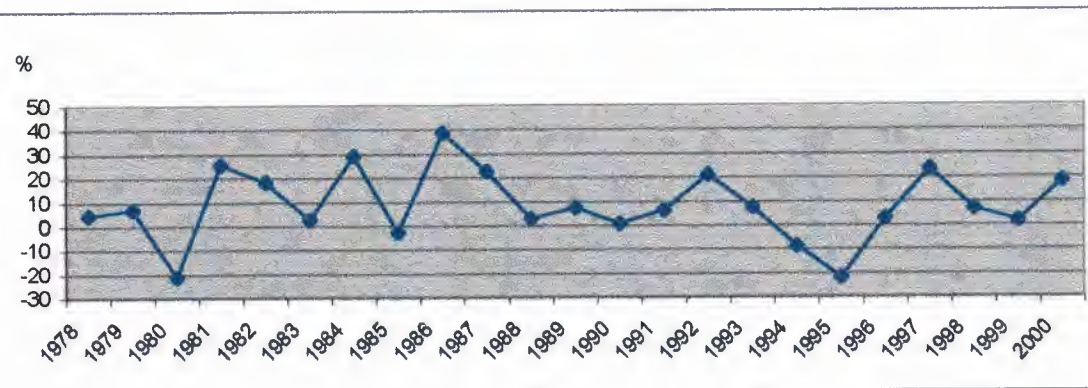
**Graph 1.15: Real Growth Rate of Sectoral Value Added of Industry (%)**



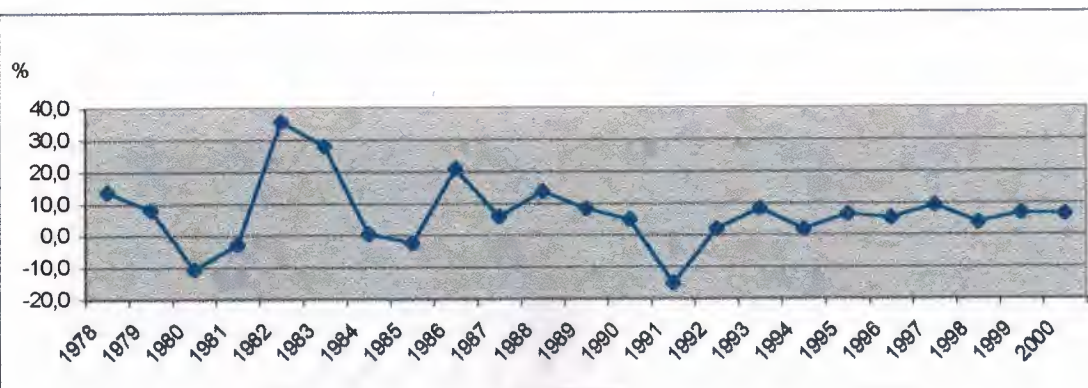
**Graph 1.16: Real Growth Rate of Sectoral Value Added of Tourism (%)**



**Graph 1.17: Real Growth Rate of Sectoral Value Added of Trade (%)**



**Graph 1.18: Real Growth Rate of Sectoral Value Added of Construction (%)**



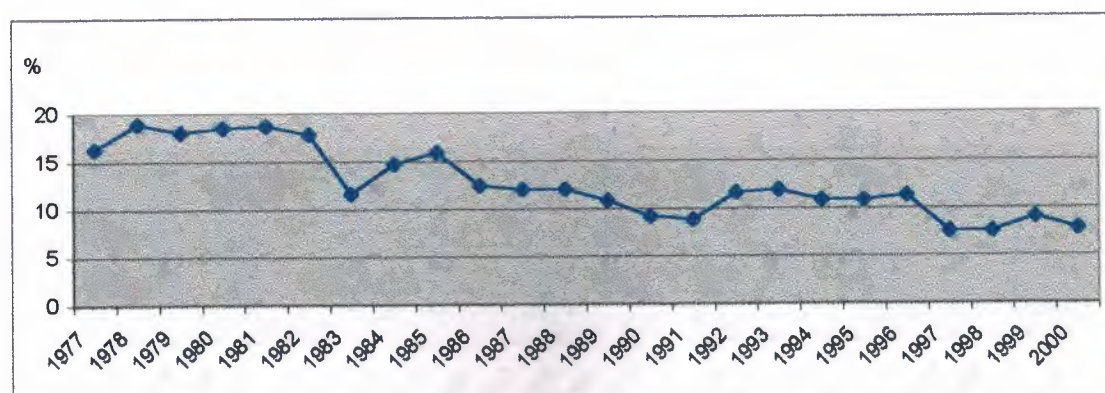
**Graph 1.19: Real Growth Rate of Sectoral Value Added of Transport and Communication (%)**



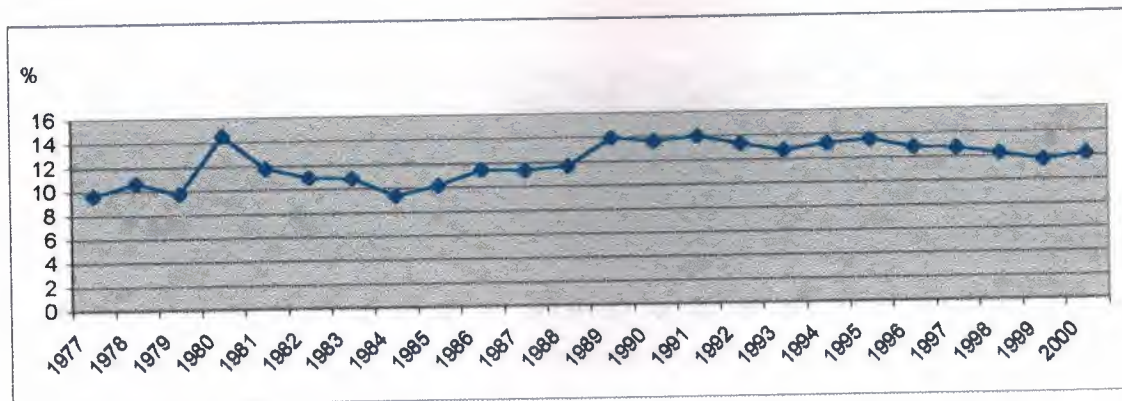
Table 1.5: Sectoral Distribution of Gross Domestic Products (%)

YEAR	AGRICULTURE	INDUSTRY	TOURISM	TRADE	CONSTRUCTION	TRANSPORT COMMUNIC.
1977	16,4	9,7	2,6	18,6	4,1	6,8
1978	19,0	10,7	2,9	16,9	4,0	7,4
1979	18,1	9,8	3,5	16,0	4,1	7,6
1980	18,6	14,6	2,7	15,7	3,2	6,8
1981	18,8	11,8	1,4	15,7	4,4	7,1
1982	17,9	11,0	2,2	17,5	4,7	8,7
1983	11,7	10,9	1,3	18,7	4,8	11,0
1984	14,8	9,4	1,6	17,8	5,8	10,5
1985	16,0	10,2	1,6	17,5	5,3	9,5
1986	12,5	11,5	1,7	17,0	7,1	11,0
1987	12,1	11,4	2,0	16,7	8,1	10,9
1988	12,1	11,7	2,3	15,8	7,7	11,6
1989	10,9	14,0	2,1	16,4	7,7	11,6
1990	9,2	13,7	2,3	16,9	7,3	11,4
1991	8,9	14,1	1,9	16,4	8,2	10,3
1992	11,7	13,4	2,5	15,3	9,3	9,7
1993	12,0	12,8	3,0	14,6	9,5	10,1
1994	10,9	13,3	3,3	14,3	9,1	10,7
1995	10,9	13,6	3,3	15,6	6,9	11,0
1996	11,4	12,9	2,8	13,5	6,8	11,2
1997	7,6	12,8	3,0	13,5	8,1	11,8
1998	7,6	12,3	3,0	14,3	8,3	11,6
1999	9,1	11,7	3,1	14,2	7,8	11,6
2000	7,9	12,2	3,2	13,2	9,3	12,3

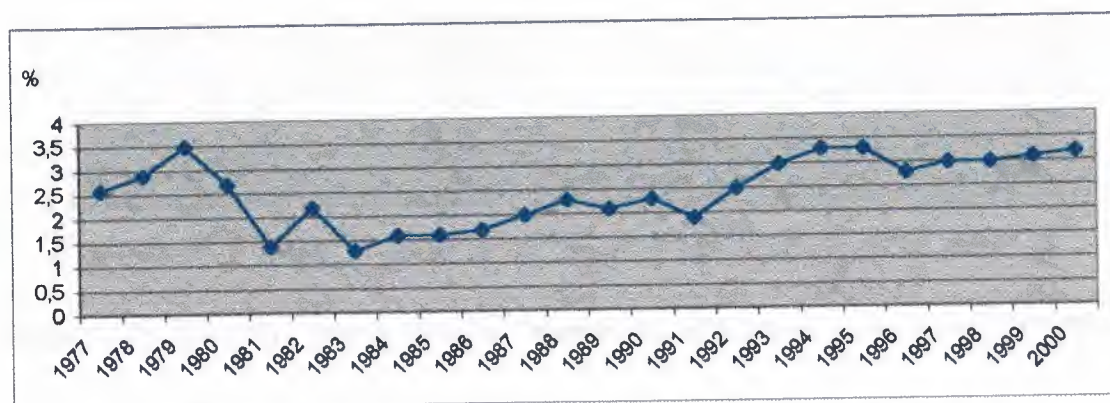
Source: TRNC Prime Ministry, SPO, Economic and Social Indicators 2000



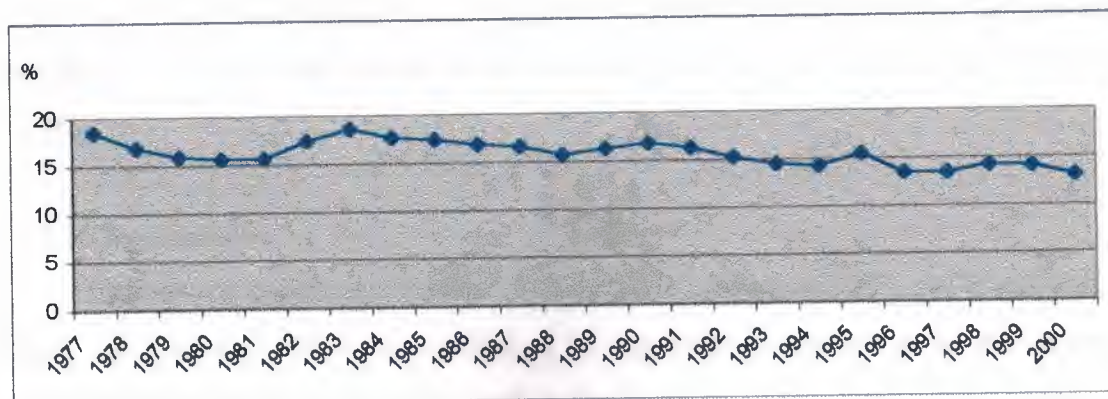
Graph 1.20: Sectoral Contribution of Agriculture to GDP (%)



**Graph 1.21: Sectoral Contribution of Industry to GDP (%)**

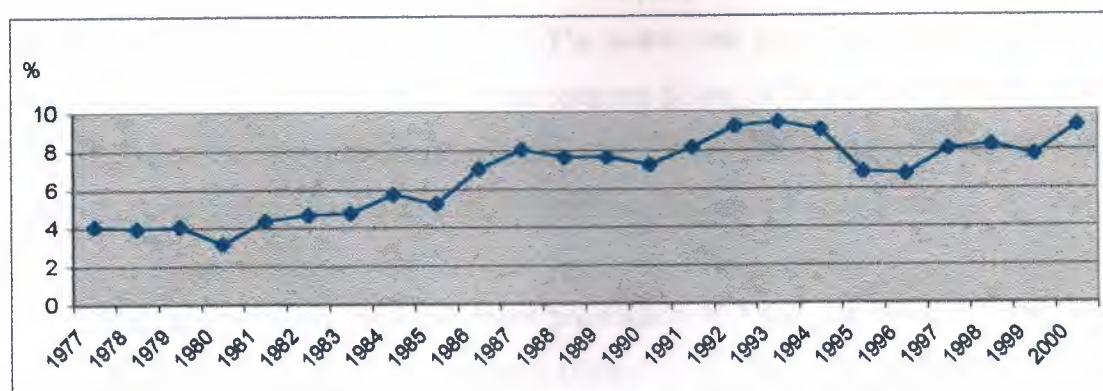


**Graph 1.22: Sectoral Contribution of Tourism to GDP (%)**

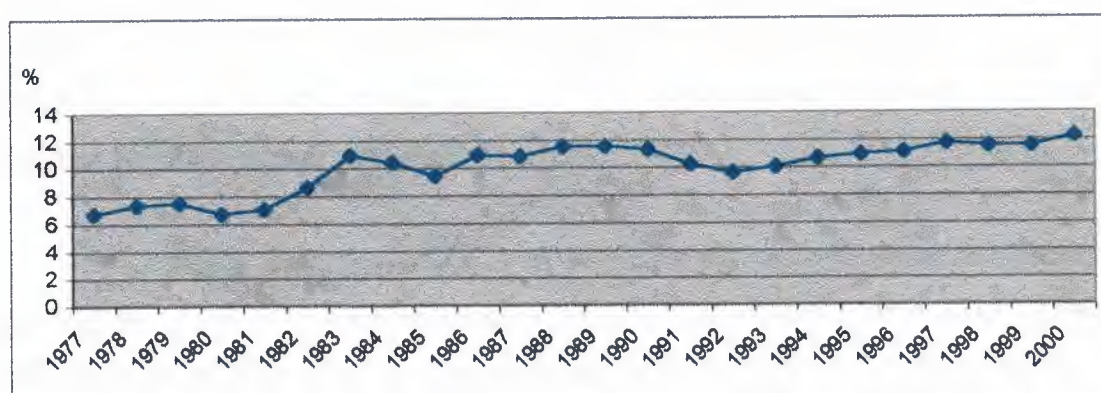


**Graph 1.23: Sectoral Contribution of Trade to GDP (%)**





**Graph 1.24: Sectoral Contribution of Construction to GDP (%)**



**Graph 1.25: Sectoral Contribution of Transport and Communication to GDP (%)**

### 1.3.2. Analysis of Sectoral Developments of TRNC

Sectoral developments of several sectors of TRNC in the period of 1977 – 2000 are examined.<sup>12</sup> The main sectors, agriculture, industry, tourism, trade, construction, transport and communication, financial institutions, business and personnel services are selected. Also, public services and import duties are examined in the same period. (1977 – 2000)

#### 1.3.2.1. Agriculture

Agricultural production was 619.3 million TL in the year 1977, and it was 713.5 million TL with the 1977 prices (Table 1.3). Agricultural production increased only 15% in the period of 24 years. The peak agricultural production was 891.1 million TL with the constant prices of 1977, in the year 1993. Graph 1.8 shows the sectoral

<sup>12</sup> TRNC Prime Ministry, SPO, *Economic and Social Indicators 2000*, pp. 8-11



development of agriculture in this period of 24 years. Because of the changes of the climate agricultural production fluctuated. The worst year was 1983 and the agricultural production was 512.3 million TL with the constant prices of the year 1977. As it is seen from the Graph 1.8 the agricultural production of TRNC was in the range of 600 – 850 million TL, with the constant prices of 1977, during the period of 24 years.

The fluctuations in the agricultural production of TRNC can be seen better when the growth rates of the sector is examined. (Graph 1.14) The worst years were the years 1983 and 1997, where the agricultural production decreased by 33.7% and 31.0% respectively. (Table 1.4) The average growth rate of the agricultural production was only 2.20% in the period of 24 years starting from 1977 and ending at 2000. These growth rates imply 1.15 times more growth in agricultural production in 24 years, which is not satisfactory. Although agricultural production had large subsidies, in TRNC the sectoral development was not satisfactory.

The climate conditions and lack of water are the main problems of agricultural production of TRNC. Another problem is the size of production units. Modern production techniques were not adapted to the agriculture of TRNC. Marketing is also a big problem in agricultural products especially fruits, vegetables, olive etc. In some years, the outputs of some products were too excessive for the domestic market and since there wasn't any export organization for these excess products the production fell down in subsequent years.

The European Union (EU) started from the year 1994 on, not to accept the certificate of origins and health certificates of TRNC. This affected the agricultural production of TRNC. Untill 1994 TRNC was exporting potatoes and citrus especially to United Kingdom and to other European countries. From that year on, the agricultural exports of TRNC decreased dramatically<sup>13</sup>. Potatoe production decreased and exports stopped. The production of potatoes continued only at very low level for the domestic

<sup>13</sup> Ministry of Agriculture and Forestry, Statistics and Planning Division, **Agricultural Structure and Production**, Nicosia, 1977, pp. 1-43

market. Citrus production also decreased to the level of less than 50% of the year 1974<sup>14</sup>.

The share of agricultural production to GDP decreased during the period of 24 years starting from 1977 and ending in 2000. (Table 1.5) The share of agricultural production was 16.4% of the GDP in the year 1977 but it decreased to 9.1% in the year 2000. The sectoral contribution of agriculture to GDP during the period starting from 1977 and ending in 2000 is plotted in graph 1.20. The gradual decrease of the contribution of agriculture to GDP is seen from the graph 1.20.

### 1.3.2.2. Industry

Industrial production was 365.1 million TL in the year 1977 and it was 1096 million TL with the prices of 1977 in the year 2000. There is a growth in the TRNC industry but it is not satisfactory. The development of the industry of TRNC is shown on Graph 1.10.

The growth rates of the industry of TRNC are shown in Table 1.4 and on Graph 1.15.<sup>15</sup> During the period of 24 years starting from 1977 and ending in 2000 the industry of TRNC grew in average 5.52% per year. As it is seen from the Graph 1.15 the growth of industry of TRNC were negative in the crisis years of Turkey (1981, 1984, 1994) the industry of TRNC grew in the years from 1977 up to 1989. As it is seen from the Graph 1.15, the growth rate was fluctuating, because of the new investments in TRNC and on the other hand because of the crisis in Turkish economy. From 1990 onwards, the industry of TRNC was in recession. The average growth of the 11 years from 1990 to 2000 is only 1.70%

The share of industry in GDP was 9.7% in the year 1977. The maximum share of industry in GDP, in the years 1989 – 1992, was around 14%. From 1991 on, the share of industry in GDP fell down and it was 12.2% in the year 2000. (Table 1.5) The sectoral contribution of industry to GDP is plotted on Graph 1.22.<sup>16</sup> As it is seen from

<sup>14</sup> TRNC Ministry of Agriculture and Forestry, Statistic and Planning Division, **Agricultural Structure and Production 2000**, Nicosia, 2001, p. 50-51

<sup>15</sup> TRNC Prime Ministry, SPO, **Economic and Social Indicators 2000**, p. 10-11

<sup>16</sup> *Ibid.*



Graph 1.22 the growth of industry stopped at 1990. Industrial exports decreased because TRNC lost her comparative advantages. The prices of the factors of production were higher than Turkey. Therefore industrial production decreased while industrial imports from Turkey increased

*On the other hand, because of the embargoes and the political status quo of the TRNC, the transportation costs of TRNC are very high. This is one of the reasons of why the cost of the input materials is higher in TRNC. The transportation costs also affected export prices. After 1994, the certificate of origin problems also put negative pressure on the exports of TRNC. Before 1994, garments were one of the main export items of TRNC, mainly to United Kingdom and to Germany. After 1994 when EU started not to accept the certificate of origins of TRNC, all the garment factories stopped production except a few, which had main company in the EU.*

Between TR and TRNC several special trade agreements are signed but only a few factories managed to export to Turkey<sup>17</sup>. The off-tariff barriers of Turkey, the high production costs of TRNC and also the small capacities of TRNC limited the exports to Turkey.

TRNC is a small island economy; therefore, the size of its domestic market is very small. Therefore TRNC firms always had size and capacity problems in export markets, and they worked under capacity in the domestic market. Therefore they couldn't invest for technology, packaging and advertisement. Especially from 1989 onwards, after the radical change of the Turkish economy, passing from import substitution to export-led growth model the TRNC industry was affected from high competition pressure of imports from Turkey.

The above analysis shows that the development of the industry in TRNC is not satisfactory and the TRNC industry has some structural problems which blocks its development. Therefore, radical changes in policy and new strategies are necessary.

<sup>17</sup> Sabahattin İsmail, *TC – KKTC İkili Anlaşma Protokol ve Sözleşmeleri*, İstanbul, AHA Yayınları, 2001.



### 1.3.2.3 Tourism

Total tourism services produced in the year 1977 was 99.7 million TL and it became to 288.2 million TL in the year 2000 with the prices of 1977. This means a growth of 2.89 times in the period of 24 years which is not satisfactory (Table 1.3)

The growth rates of tourism were very unstable. As it is seen from the Table 1.4 and from the Graph 1.16, in the years 1980, 1981, 1983, 1991 and 1996 the growth of tourism was negative<sup>18</sup>. The growth was not smooth; too many ups and downs took place. Sector affected from the political situations in the region and also from the political situation of Cyprus herself. The tourism sector also affected from economic situations of TRNC, Turkey and market countries.

The contribution of tourism sector to the GDP was 2.6% in the year 1977 and it was 3.2% in the year 2000. The maximum contribution of tourism to GDP was 3.5% in 1979 and 3.3% in the years 1994 and 1995. (Table 1.5) Graph 1.22 shows the contribution of tourism to GDP. As it seen from the Graph 1.22 the contribution of tourism to GDP was in the range of 2% and 3% during the period of 24 years.

Tourism was selected as the preferential sector and declared to be the locomotive sector for the development of the TRNC. Supports were given for building new tourism facilities. Several new hotels and holiday villages have been built<sup>19</sup>. Most of them has small capacity, even some of them hardly cover the fixed expences, as supports was given not only to the big projects but also to small projects. The supports sometimes was not given to the projects but was given to the owners of the projects. Political and other aspects were considered in supporting the projects. The credits did not turn back. Many inefficient and uneconomic tourism facilities were supported. As a result very weak financial structured organizations took place.

The tourism sector was never planned as a whole, starting from potential markets, marketing strategy, transportation, prices and services. Only by taking into account the climate conditions and the nature of the TRNC, tourism was decided to be

<sup>18</sup> TRNC Prime Ministry, SPO, *Economic and Social Indicators 2000*, pp. 10-11.

<sup>19</sup> KKTC Başbakanlık, DPÖ, *1998 Genel Sanayi ve İşyeri Sayımı*, Lefkoşa, KKTC Devlet Basımevi, 2000, s. 62-63

preferential, locomotive sector. The capacities were not planned. The problems of transportation, the negative pressure of the embargoes on the sector, the service prices, and other problems of tourism had not been considered.

Considering UK as one of the main tourism market of the TRNC, a tourist from UK can have a one-week holiday in South Cyprus with the cost of a travel ticket price to TRNC<sup>20</sup>. TRNC is the most expensive place in the region. Today, the tourism sector has no comparative advantage, comparing with the south region of Turkey and also as compared with South Cyprus.

On the other hand the financial situation of most of the tourism firms is very weak. They don't have enough finance to pay back their loans and also to give quality service to the tourists. The anti propaganda of South Cyprus and Greece against TRNC also affects the tourism sector of TRNC.

As it is explained above, tourism sector of TRNC has structural and strategic problems, as marketing, transportation, service prices, hotel sizes and financial positions of the firms. These structural problems have to be solved first in order to increase the contribution of tourism to TRNC economy.

#### 1.3.2.4 Trade

The volume of trade of TRNC was 701.3 million TL in the year 1977 and it became 1186.4 million TL in the year 2000 with the 1977 prices. This means 1.69 times increase in trade, again, which is not satisfactory (Table 1.3)<sup>21</sup>

In the years of 80's there was a smooth growth in the TRNC trade (Graph 1.11). In the same period Turkish government applied import substituting economy and TRNC economy was an open economy. Many goods were imported to TRNC and exported to Turkey. At the second half of 80's Turkey left import substitution and passed to export based growth, hence the Turkish economy became more liberal and open. Importing goods from other countries and sending them to Turkey decreased in TRNC. As it is

<sup>20</sup> Northern Cyprus Hoteliers Association, **KITOB News**, March-April 2001, Issue 18, p.27

<sup>21</sup> TRNC Prime Ministry, SPO, **Economic and Social Indicators 2000**, pp 8-9



seen from the Graph 1.11 there was a recession in the trade sector in the years 1991 – 1994. After these years, imports from other countries shifted to Turkey and the volume of the trade sector started to increase again.

The growth rates of trade sector can be seen from Table 1.4<sup>22</sup>. The average growth rate of trade was 2.5% per year during the period of 24 years, which is not satisfactory. Since the production and exports were not growing satisfactorily then the growth of trade was not satisfactory. The isolations and embargoes affected the TRNC trade. The production costs and exports prices increased. The competition power of TRNC products in the world market decreased. Therefore, while exports decreasing the imports increased, hence TRNC had a huge foreign trade gap.

Trade was 18.6% of the total GDP in the year 1977, but this share decreased to 13.2% in the year 2000. This also shows that the growth of trade was not satisfactory during the 24 years starting from 1977 and ending in 2000. (Table 1.5 and Graph 1.23)

### 1.3.2.5 Construction

The volume of construction sector of TRNC was 153 million TL in the year 1977 and it increased to 841.4 million TL in the year 2000 with the prices of 1977. (Table 1.3) The growth was 5.49 times during the period of 24 years.<sup>23</sup>

In the years between 1977 and 1982, the growth of construction sector was negligible because of the new settlement of Turks in North Cyprus. There were a lot of vacant buildings left by the Greek Cypriots, which had to be occupied first.

In the years of 1980's new infrastructures were constructed. Kyrenia port, new highways between Famagusta, Lefkoşa and Kyrenia were constructed. New hotels and touristic buildings were constructed. Also many Turkish Cypriots living in other countries built or bought a house in Northern Cyprus. As a result of these investments the construction sector increased rapidly in these years. (Graph 1.12)

<sup>22</sup> *Ibid.*, pp. 10-11

<sup>23</sup> *Ibid.*, pp. 8-9



The years 1994, 1995 was crisis years of Turkish and TRNC economies. Therefore construction stopped. Then construction sector started to increase again. After these years, the renewals of the roads and enlargements of highways of TRNC started. The enlargement of Lefkoşa – Kyrenia and Lefkoşa – Famagusta highways took place, which gave upward trend to construction sector. (Graph 1.12)

The growth rates of the construction sector are seen in Table 1.4<sup>24</sup>. The crisis in Turkish economy affected directly in negative way to the construction sector of TRNC. The finance of the building of the infrastructures of TRNC has been made directly from Turkey. Therefore in the crisis years of Turkey the flow of finance to the infrastructure projects decreased. The construction sector grew 8.32% per year in average during this period, which is satisfactory.

The contribution of construction to GDP was 4.1% in the year 1977 and it increased to 9.3% in the year 2000. (Table 1.5)<sup>25</sup> Sectoral contribution of construction to GDP of TRNC is shown in Graph 1.24 The gradual increase of the construction sector of TRNC is seen in Graph 1.24 except the crisis years of Turkey.

### 1.3.2.6 Transport and Communication

The volume of transport and communication sector was 257.4 million TL in the year 1977 and it became 1113.5 in the year 2000 with the prices of 1977 (Table 1.3) the sector grew 4.32 times during the period of 24 years<sup>26</sup>. As it is said above, there were a lot of investments on the infrastructure of TRNC, mainly roads, telecommunications and ports (both air and sea ports) all of which were financed from Turkey. Therefore transport and communication sector developed satisfactorily.

The development of transport and communication sector can be seen from the Graph 1.13. The growth is smooth; there is a drop in the year 1991 which can be explained by the Gulf Crisis in the region.

<sup>24</sup> *Ibid.*, pp. 10-11

<sup>25</sup> *Ibid*

<sup>26</sup> *Ibid.*, pp. 8-9

The growth rate of transport and communication sector was 12.0% in the year 1978 and 6.7% in the year 2000. (Table 1.4) The average growth rate of the sector was 7.11% per year. The growth rates of the transport and communication sector can be seen on Graph 1.19.<sup>27</sup>

Transport and communication sector was 6.8% of the GDP in the year 1977 and it became 12.3% of the GDP in the year 2000. (Table 1.5) The sectoral contribution of Transport and Communication to the GDP of TRNC is seen on the Graph 1.25.<sup>28</sup>

There were satisfactory investments on transport and communication infrastructure. The political situation of Cyprus affected to the transportation sector of TRNC. The same distance transport to and from TRNC is expensive compared the other countries in the same region. There isn't any direct flight to TRNC except from Turkey. Therefore the excess connections increase the transportation costs.

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<sup>27</sup> Ibid., pp. 10-11

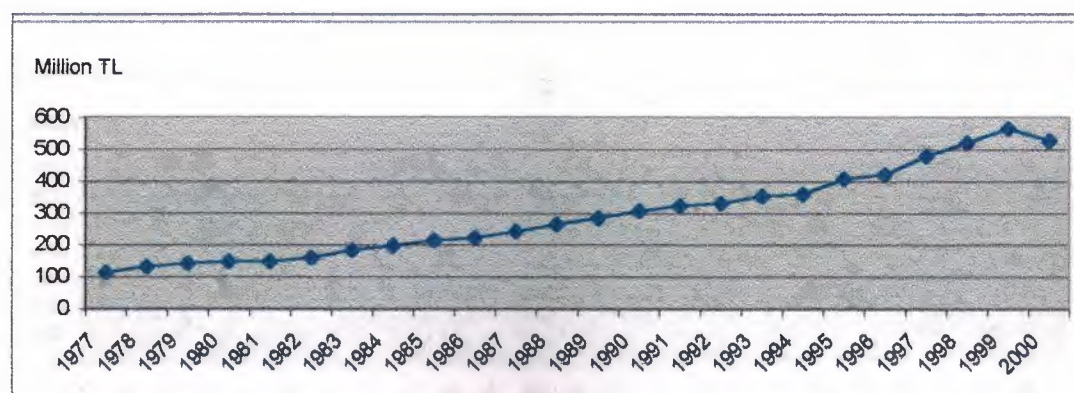
<sup>28</sup> Ibid.



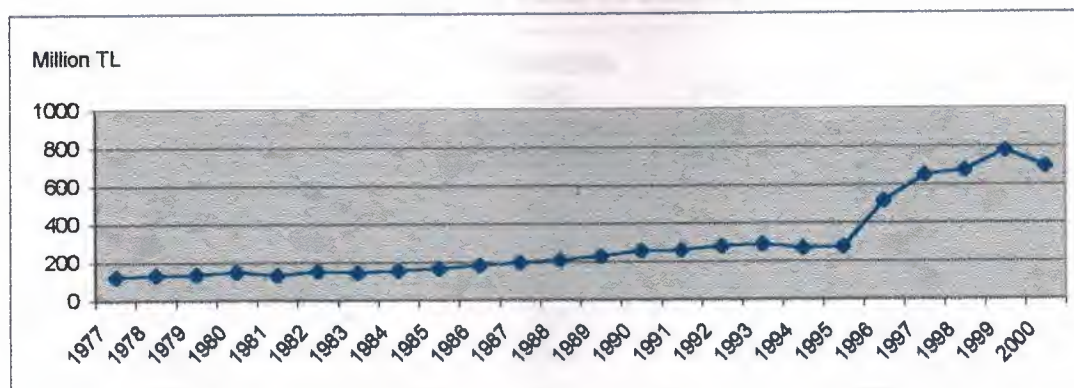
**Table 1.6: Indicators of Sectoral Developments (1977 prices million TL)**

YEAR	FINANCIAL INSTITUTIONS	BUSINESS AND PERSONNEL SERVICES	PUBLIC SERVICES	IMPORT DUTIES
1977	115,4	128,1	752,7	228,2
1978	135,4	135,8	765,6	168,2
1979	144,6	140,7	900,5	150,5
1980	150,1	152,3	894,6	87,6
1981	151	137,4	892,1	81,3
1982	163,5	157,1	911,8	86,9
1983	187,6	151,4	996,3	169,4
1984	201,6	162,1	1019,9	155,3
1985	217,5	169,4	1115	151,5
1986	224,1	188,2	1137,2	160,5
1987	244,5	201,1	1181,2	181,4
1988	266,3	214,2	1197,8	286,1
1989	287,5	235,7	1227,7	312,1
1990	310	259,3	1278,1	491,7
1991	326	263,1	1292,6	363,6
1992	333,9	284,1	1303,6	392,2
1993	354,2	294,1	1320,8	457,5
1994	361,6	274,8	1346,2	357,5
1995	409,5	280,6	1316,8	428,6
1996	423,7	518,7	1351,1	449,5
1997	482,1	655,7	1358,6	521,1
1998	524,4	679,2	1406,1	547,6
1999	568,4	784	1438,6	584,4
2000	529,6	700	1483,3	604,5

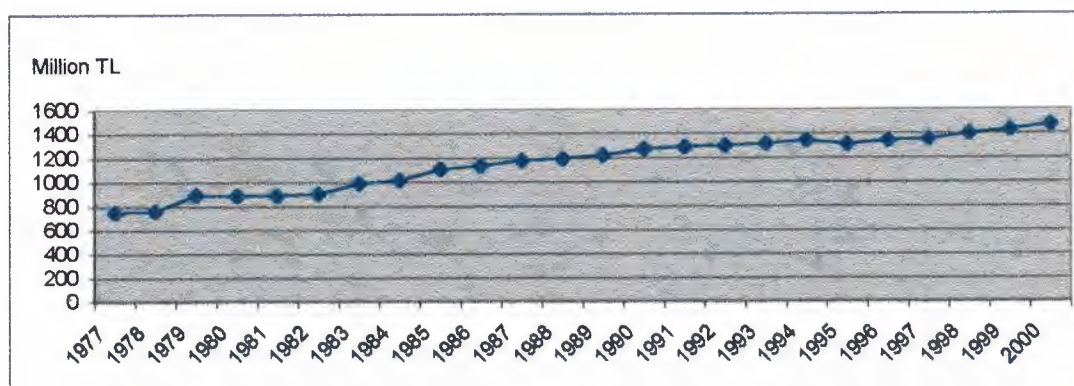
Source: TRNC Prime Ministry, SPO, Economic and Social Indicators 2000

**Graph 1.26: Sectoral Development of Financial Institutions (1977 prices million TL)**

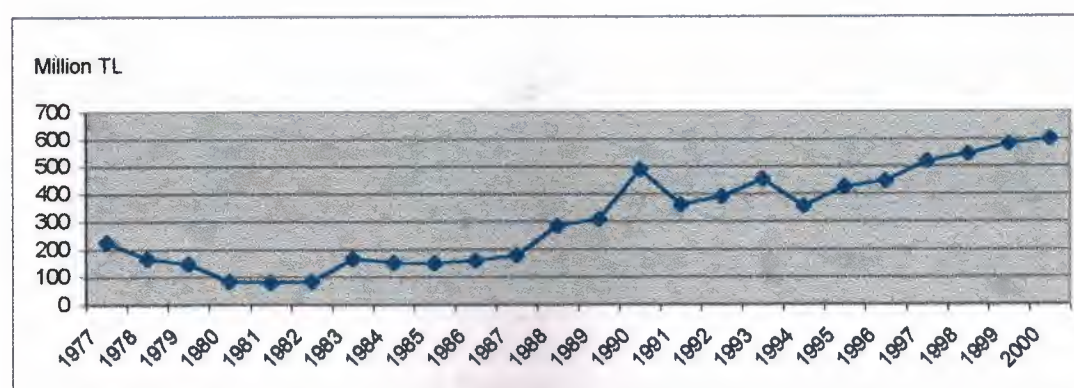




**Graph 1.27: Sectoral Development of Business and Personal Services (1977 prc)**



**Graph 1.28: Sectoral Development of Public Services (1977 prc)**

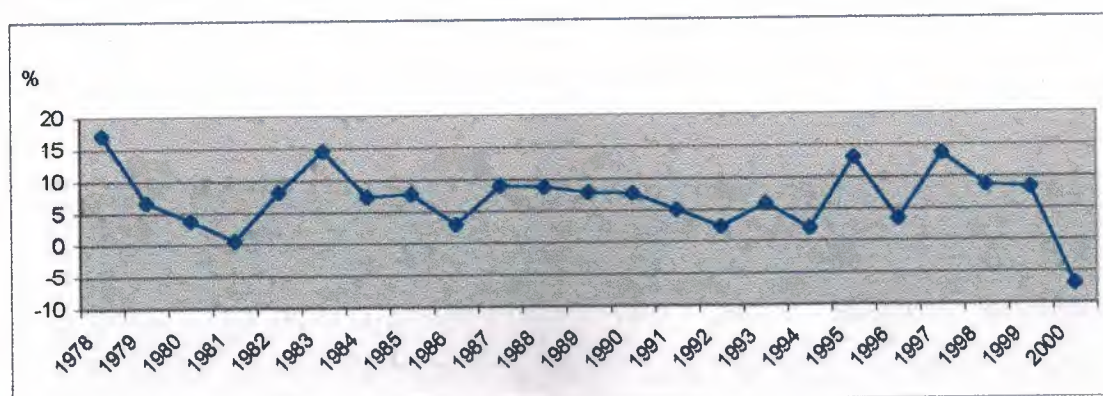


**Graph 1.29: Sectoral Development of Import Duties. (1977 prc)**

Table 1.7: Real Growth Rates of Sectoral Value added (%)

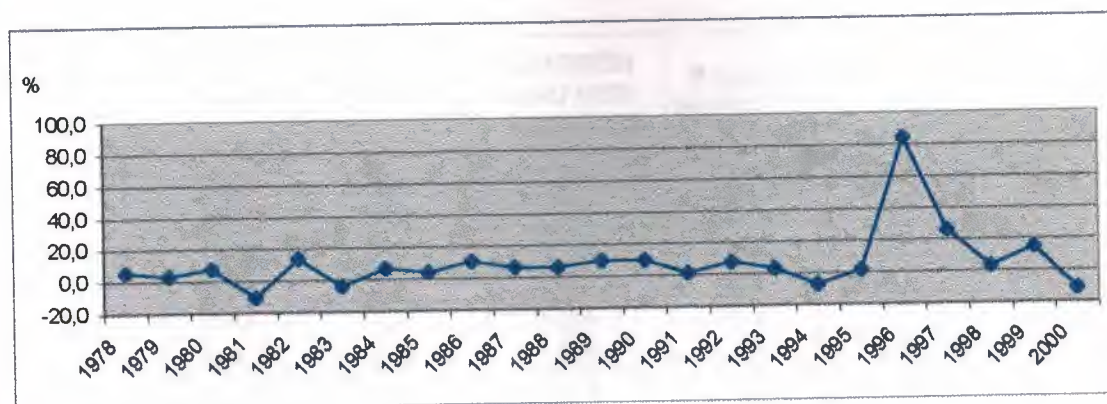
YEAR	FINANCIAL INSTITUTIONS	BUSINESS AND PERSONNEL SERVICES	PUBLIC SERVICES	IMPORT DUTIES
1978	17,3	6,0	1,7	-26,3
1979	6,8	3,6	17,6	-10,5
1980	3,8	8,2	-0,7	-41,8
1981	0,6	-9,8	-0,3	-7,2
1982	8,3	14,3	2,2	6,9
1983	14,7	-3,6	9,3	94,9
1984	7,5	7,1	2,4	-8,3
1985	7,9	4,5	9,3	-2,4
1986	3,0	11,1	2,0	5,9
1987	9,1	6,9	3,9	13,0
1988	8,9	6,5	1,4	57,7
1989	8,0	10,0	2,5	9,1
1990	7,8	10,0	4,1	57,5
1991	5,2	1,5	1,1	-26,1
1992	2,4	8,0	0,9	7,9
1993	6,1	3,5	1,3	16,5
1994	2,1	-6,6	1,9	-21,8
1995	13,2	2,1	-2,2	19,9
1996	3,5	84,8	2,6	4,9
1997	13,8	26,5	0,6	15,9
1998	8,8	3,6	3,5	5,1
1999	8,4	15,5	2,3	6,7
2000	-6,8	-10,7	3,1	3,4

Source: TRNC Prime Ministry, SPO, Economic and Social Indicators 2000

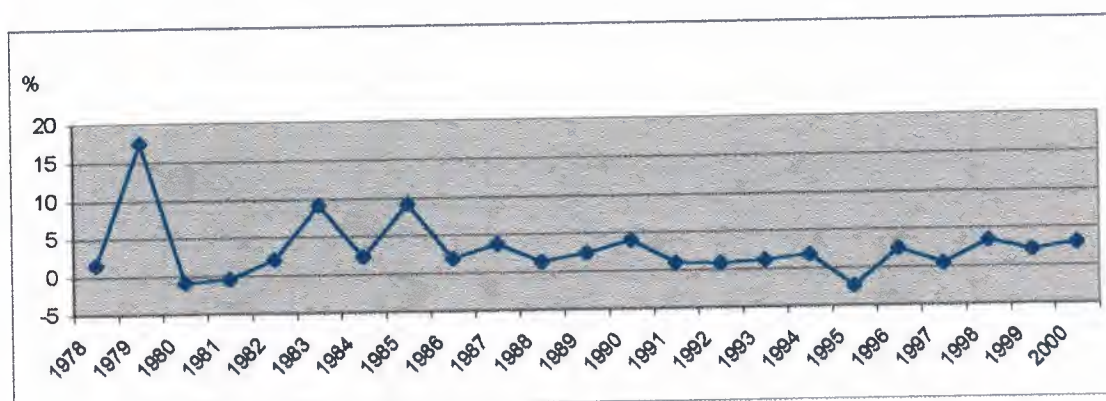


Graph 1.30: Real Growth Rate of Sectoral Value Added of Financial Institutions (Percent %)

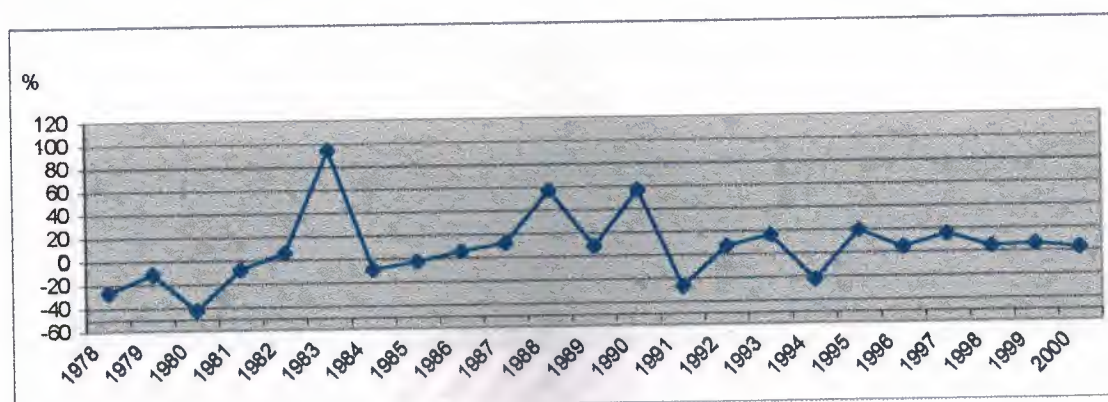




**Graph 1.31: Real Growth Rate of Sectoral Value Added of Business and Personal Services (%)**



**Graph 1.32: Real Growth Rate of Sectoral Value Added of Public Services (%)**



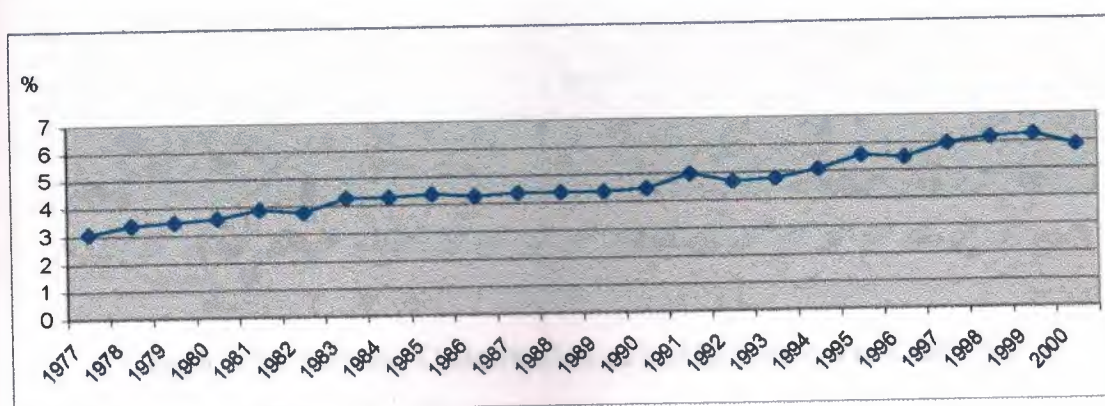
**Graph 1.33: Real Growth Rate of Sectoral Value Added of Import Duties (%)**



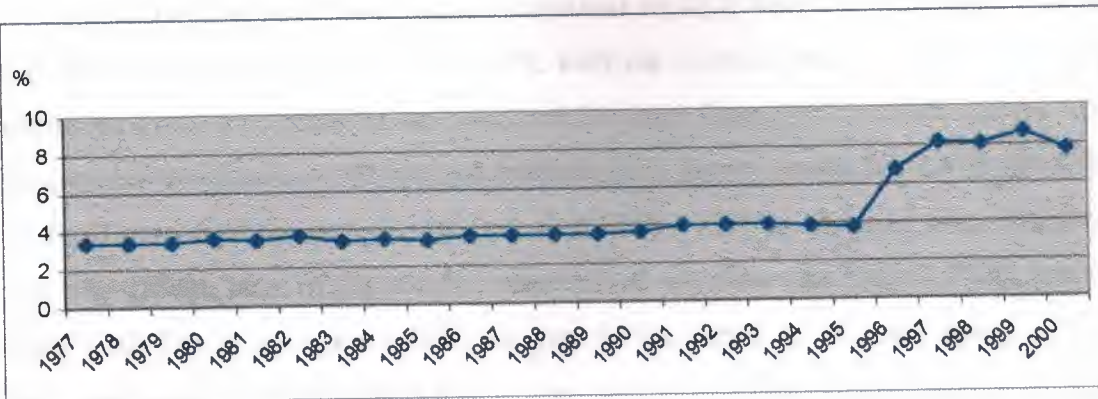
**Table 1.8: Sectoral Distribution of Gross Domestic Products (%)**

YEAR	FINANCIAL INSTITUTIONS	BUSINES AND PER. SERVICES	PUBLIC SERVICES	IMPORT DUTIES
1977	3,1	3,4	19,9	6,0
1978	3,4	3,4	19,2	4,2
1979	3,5	3,4	21,6	3,6
1980	3,6	3,6	21,3	2,1
1981	3,9	3,5	22,9	2,1
1982	3,8	3,7	21,1	2,0
1983	4,3	3,4	22,7	3,9
1984	4,3	3,5	22,0	3,3
1985	4,4	3,4	22,3	3,0
1986	4,3	3,6	21,7	3,1
1987	4,4	3,6	21,2	3,3
1988	4,4	3,6	20,0	4,8
1989	4,4	3,6	18,8	4,8
1990	4,5	3,7	18,4	7,1
1991	5,0	4,0	19,7	5,5
1992	4,7	4,0	18,4	5,5
1993	4,8	4,0	17,8	6,1
1994	5,1	3,9	18,8	5,0
1995	5,6	3,8	17,9	5,8
1996	5,5	6,8	17,7	5,9
1997	6,0	8,2	17,1	6,5
1998	6,2	8,1	16,8	6,5
1999	6,3	8,7	16,0	6,5
2000	5,9	7,8	16,4	6,7

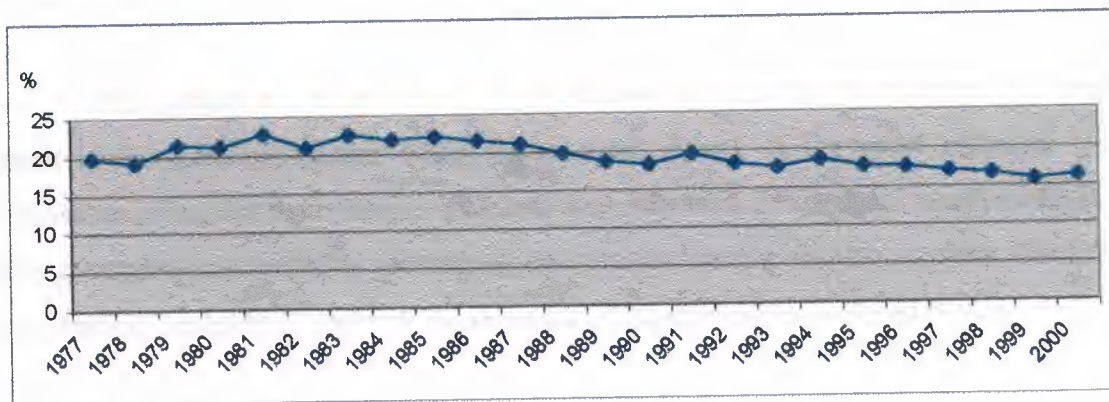
Source: TRNC Prime Ministry, SPO, Economic and Social Indicators 2000



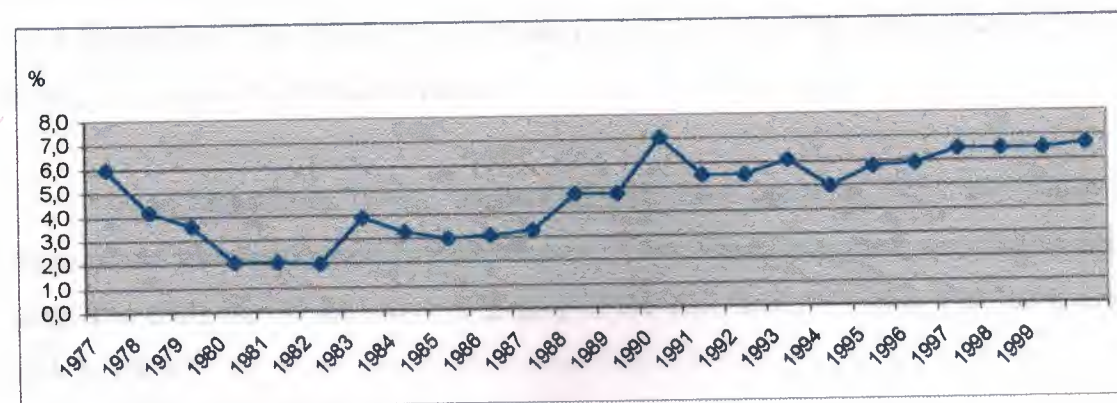
**Graph 1.34: Sectoral Contribution of Financial Institutions to GDP (%)**



**Graph 1.35: Sectoral Contribution of Business and Personal Services to GDP (%)**



**Graph 1.36: Sectoral Contribution of Public Services to GDP (%)**



**Graph 1.36: Sectoral Contribution of Public Services to GDP (%)**



### 1.3.2.7. Financial Institutions

The contribution of the financial intuitions to GDP was 115.4 million TL in the year 1977 and it became 529.6 million TL with the constant prices of 1977. Financial institutions grew 4.58 times in the period of 24 years from 1977 to 2000. (Table 1.6) The sectoral development of Financial Institutions is shown graphically on Graph 1.26. The rapid growth of the sector in the period of 1987 – 1999 can be seen from the Graph 1.26. The growth rates of the sectoral value added are shown in Table 1.7 and also on Graph 1.30. The sector grew 6.68% per year in the period of 24 years during 1977 – 2000. The growth was minus 6.8% in the year 2000. The sectoral contribution of financial Institutions to GDP was 3.1% in the year 1977 and it increased to 5.9% in the year 2000. (Table 1.8) The sectoral Contribution of financial Institutions to GDP shown on Graph 1.34<sup>29</sup>

The growth of the sector was not healthy. In the year 2000 TRNC had a big crisis in financial institutions. Many banks were closed. A big panic occurred. The depositors rushed to the banks to withdraw their deposits. The system nearly collapsed. The government gave 100% guaranty to the deposits and the rushing stopped. Then, the government accepted to payback the deposits of the depositors in closed banks.

The TRNC government gave permission for the establishment of new banks to the companies that had a very little initiating capital. Most of the banks collected deposits with very high interest rates and gave credits to their shareholders and their sister companies. The credits were never paid back. Also the central bank couldn't manage to control the financial system.

Some banks from Turkey, established their sister banks in TRNC and collected deposits and transferred their funds to Turkey. These banks also gave very high interest rates. The crisis started with the bankruptcy of the main bank in Turkey that had a sister bank in TRNC.

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<sup>29</sup> Ibid., pp. 8-11



### 1.3.2.8 Business and Personnel Services

The contribution of the service sector to the GDP was 128.1 million TL in the year 1977. The sector enlarged and it became 700 million TL in the year 2000 with the prices of 1977. The growth was 5.46 times in the period of 24 years from 1977 to 2000. The peak of the service sector was at 1999 when the volume of the sector was 784 million TL with the constant prices of 1977. (Table 1.6 and Graph 1.27) The sector grew 8.45% per year in average in the period of 24 years from 1977 to 2000. (Table 1.7 and Graph 1.31)<sup>30</sup>

The growth of the service sector is accelerated at the end of 80's because of the establishment of the universities in Northern Cyprus and which offered higher education service to the students not only from Northern Cyprus students but also to students from Turkey and other countries. In the year 2000 TRNC had five universities and was offering higher education to more than 20000 students coming from Turkey, Middle East and Asia as well as Northern Cyprus students. The service sector became vulnerable from the crisis of the main market Turkey. Therefore the growth rate was negative in the years 1994 and 2000 because of the crisis in the Turkish economy (Table 1.7)

The distribution of the service sector to the GDP is shown in Table 1.8. As it is seen from the table, the service sector was 3.4% of the GDP in the year 1977 and it became 7.8% in the year 2000. The contribution of the service sector to GDP is plotted in Graph 1.35.<sup>31</sup> As it is seen the share of service sector in GDP had a rapid increase after the establishment of the universities.

### 1.3.2.9. Public Services

Public services were 752.7 million TL of the GDP in the year 1977 and it became 1483.3 million TL in the year 2000 with the prices of 1977. (Table 1.6) The development of the public services sector is shown on Graph 1.28. The average growth of the public services was 2.93% per year during the period of 24 years from 1977 to en 2000. The real growth rates of the public sector can be seen in Table 1.7. The sectoral

<sup>30</sup> Ibid., pp. 8-11

<sup>31</sup> Ibid., pp. 10-11

distribution of the public sector to the GDP was 19.9% in the year 1977 and it decreased to 16.4% in the year 2000. (Table 1.8) The sectoral contribution of public services to GDP is plotted on Graph 1.36.<sup>32</sup>

The portion of public services in the GDP was always very big. If the figures of public services are compared with the figures of other sectors in yearly basis, it is easy to see that; the public sector of TRNC was always too big. Many people employed in public services. The share of the salary payments in the budgets of TRNC was always too high. This gave upward pressure to the prices of public services and also caused the taxes to increase. In addition, the effectiveness and efficiency of public services decreased.

The over employment in public administration took the big portion of the funds of the budget of TRNC as salaries of civil servants and as for the transfer payments to retired civil servants. Therefore, the budget deficits of TRNC increased every year. The TRNC economy became more dependent on the aids from motherland Turkey who always financed the budget deficits.

The increased prices of public services and the increased level of taxes put upward pressure to the production costs of TRNC, which affected the competitive advantages of TRNC negatively. The combined effects of the embargoes, isolations and over employment in public sector decelerated the growth of the private sector of the TRNC.

The results of unsatisfactory economic growth of the TRNC were seen in the unemployment and migration of the young population of TRNC.

#### **1.3.2.10 Import Duties**

The amount of import duties in GDP was 228.2 million TL in the year 1977 and it was 604.5 million TL in the year 2000 with the constant prices of 1977. (Table 1.6) The growth of import duties is shown on Graph 1.29. The import duties of TRNC doubled in the period of 24 years, which shows the increase of imports of TRNC. The

<sup>32</sup> Ibid., pp. 8-11



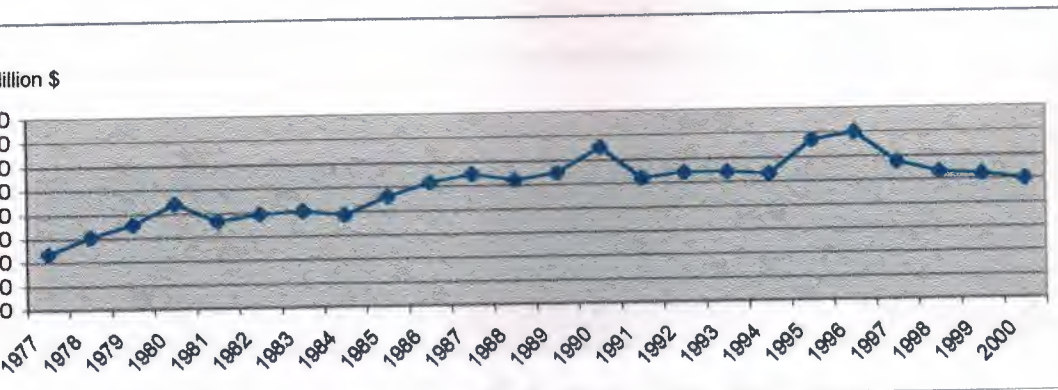
sectoral distribution of GDP to import duties is shown in Table 1.8. As it can be seen from the Graph 1.37 the import duties was always contributed 4 – 8% of the GDP. As it can be seen from these analyses the big portion of the trade of TRNC has been imports. The share of import duties was more then 5.5% in the years of 90's. (Table 1.8)<sup>33</sup> This is an indicator of the trend of imports in the economy of TRNC.

**Table 1.9: Foreign Trade Indicators of TRNC (Million \$)**

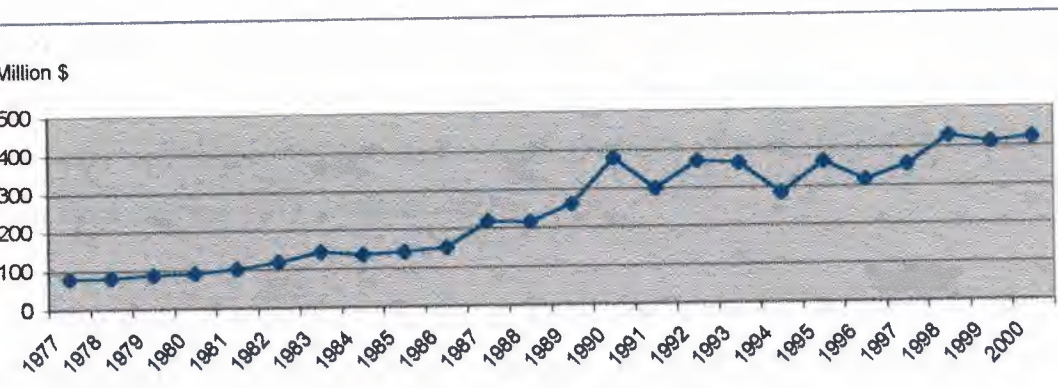
YEAR	EXPORTS	IMPORTS	NET TOURISM REVENUE	FOREIGN TRADE BALANCE Million \$	EXPORTS / IMPORTS (%)
1977	23,9	82	30,2	-58,1	29,1
1978	30,8	84,2	33,5	-53,4	36,6
1979	35,8	90,8	33,7	-55	39,4
1980	44,5	94,4	24	-49,9	47,1
1981	36,8	104,1	23,9	-67,2	35,4
1982	39,5	119,9	27,2	-80,4	32,9
1983	40,7	145,3	37,1	-104,6	28
1984	38,8	136,3	40,3	-97,5	28,5
1985	46,3	143	47,3	-96,7	32,4
1986	52	153,2	52	-101,2	33,9
1987	55,1	221	103,5	-165,9	24,9
1988	52,4	218,1	118	-165,7	24
1989	55,2	262,5	154,9	-207,3	21
1990	65,5	381,5	224,8	-316	17,2
1991	52,5	301,1	153,6	-248,6	17,4
1992	54,6	371,4	175,1	-316,8	14,7
1993	54,5	363,9	224,6	-309,4	15
1994	53,4	286,6	172,9	-233,2	18,6
1995	67,3	366,1	218,9	-298,8	18,4
1996	70,5	318,4	175,6	-247,9	22,1
1997	57,7	356,6	183,2	-298,9	16,2
1998	53,4	430,5	186	-377,1	12,4
1999	52,4	412,7	192,8	-360,3	12,7
2000	50,4	424,9	198,3	-374,5	11,9

Source: TRNC Prime Ministry, SPO, Economic and Social Indicators 2000

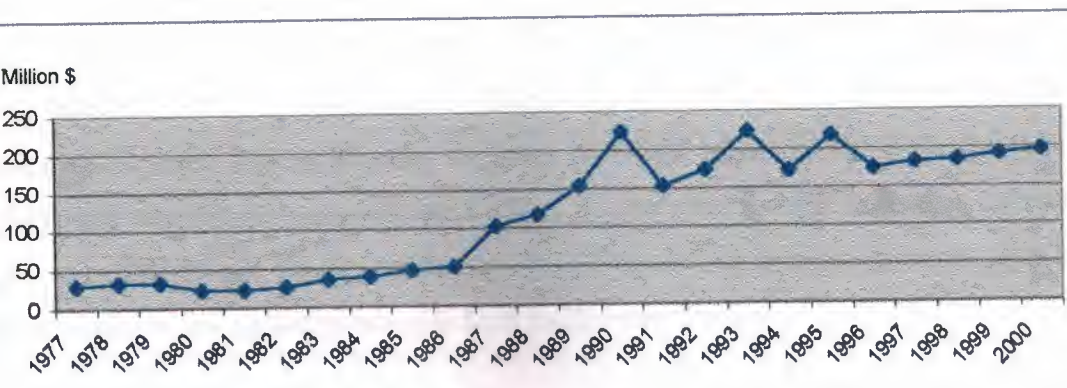
<sup>33</sup> Ibid.



**Graph 1.38: Exports of TRNC (Million \$)**

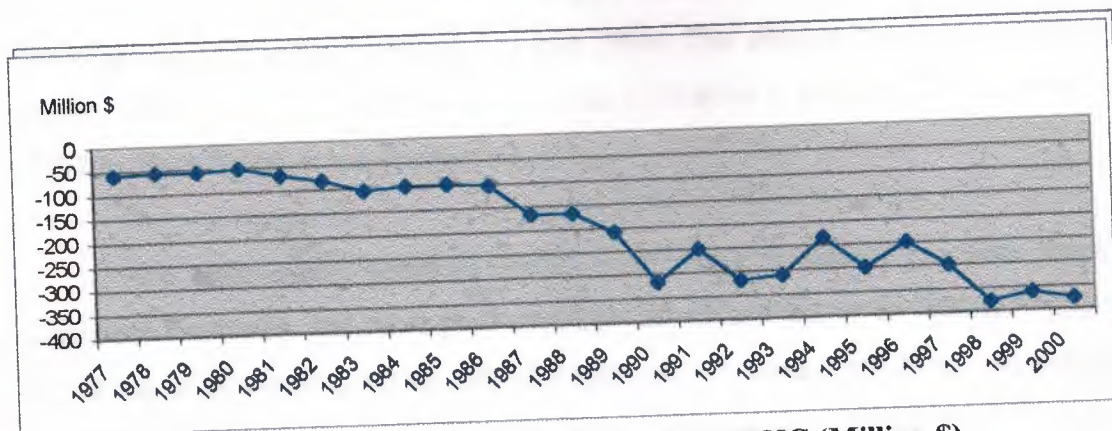


**Graph 1.39 Imports of TRNC (Million \$)**



**Graph 1.40: Net Tourism Revenues of TRNC (Million \$)**





**Graph 1.41: Foreign Trade Balance of TRNC (Million \$)**

### 1.3.3. Analysis of Foreign Trade Indicators of TRNC

The foreign trade gap of TRNC gradually increased. As it can be seen from Table 1.9<sup>34</sup> the foreign trade balance was -58.1 million USD in the year 1977. This figure never approached to zero but the gap gradually opened. In the year 2000 the foreign trade gap was -374.5 million USD.

The ratio of exports to imports of TRNC has gradually decreased. In the year 1977 the exports of TRNC was 29.1% of imports of TRNC. The best year was 1980 at which the exports of TRNC were 47.1% of the imports of TRNC. Then the imports increased more rapidly than the exports. As a result of this, the exports of TRNC was only 11.9% of the imports in the year 2000.

The net tourism revenues were 30.2 million USD in the year 1977 and became 198.3 million USD in the year 2000<sup>35</sup>. There was an increase of 6.56 times during the period of 24 years. The net tourism revenues of TRNC increased but never the sum of exports and tourism revenues became enough to close the foreign trade gap. Although every year TRNC had foreign trade gap TRNC never had external payment problem. The payments were settled by the aids from motherland Turkey.

<sup>34</sup> Ibid., pp. 2-3

<sup>35</sup> Ibid.

### 1.3.3.1 Exports

In 1977 exports of TRNC were 23.9 million USD. (Table 1.9) The exports increased to 50.4 million USD in the year 2000. The change in exports is shown on Graph 1.38. Exports of TRNC increased only 2.10 times in the period of 24 years from 1977 to 2000.<sup>36</sup> This is not satisfactory.

The main export items of TRNC were citrus, potatoes, garments mainly to European Countries, and dairy products, light drinks and others to Turkey.<sup>37</sup> From the beginning of this period, up to 1984 the basic export items were fruits and vegetables (mainly citrus and potatoes). Exports were mainly to the United Kingdom and to Netherlands. After mid 80's garment exports mainly to UK and to Germany increased. Some of the Turkish Cypriot textile businessmen from UK established garment production in TRNC. At those years there were quotas to the garment exports of Turkey. Therefore Turkish garment exporters also made production and exports from TRNC. New garment factories were established for garment exports. The rapid growth of exports between 1982 and 1996 can be seen from Table 1.9 and from the Graph 1.38. The peak of the TRNC exports was in the year 1996 with 70.5 USD.

In august 1994, European Court of Justice gave a decision and the European Countries started not to accept the TRNC health certificates for fruits and vegetables. In a few years citrus and potatoes exports to European countries decreased. With the same court decision European Countries also started not to accept the certificate of origins from TRNC. This was an extra cost of 14% for the garment exports of TRNC. In a few years garment exports decreased, many factories were closed. After a few years, only some large factories, which had their head offices in the UK, were left and only those factories managed to compensate the extra costs of European embargoes, which started, with the above decision of European Court of Justice. Meanwhile, Turkey established Customs Union with EU and Turkish exporters left the TRNC.

<sup>36</sup> Ibid.

<sup>37</sup> Ekonomiden Sorumlu Devlet Bakanlığı ve Başbakan Yardımcılığı, Ticaret Dairesi, **Dış Ticaret İthalat ve İhracat Statistikleri 2001**, s. 278-281



After 1994 exports to Turkey increased. Some special agreements made for exporting TRNC products to Turkey. The exports of TRNC were 50.4 million USD in the year 2000, which is not satisfactory.

### 1.3.3.2 Imports

Imports of the TRNC were 82 million USD in the year 1977. After 24 years, in the year 2000 imports of TRNC was 424.9 million USD. (Table 1.9) The imports of TRNC increased 5.2 times during this period. (Graph 1.39)<sup>38</sup>

The imports of TRNC increased very rapidly up to the year 1990. During these years Turkish economy was an import substituting economy, therefore there were barriers against the imports of consumer goods to Turkey. On the other hand, in these years the imports regime of TRNC was relatively liberal then Turkey. Consumer goods were imported to TRNC and exported to Turkey by some special regulations. A special type of tourism generated between Turkey and TRNC. Many people came to TRNC just for buying imported goods and selling them in Turkey.

In 1980s Turkey gave up import substitution, then imports to Turkey became easier. The result of this change in the Turkish economy was the decrease of reexports to Turkey from TRNC. Hence decrease in the imports of TRNC. As it is seen from the Graph 1.39 the rapid increase of imports of TRNC stopped.

The isolations and embargoes affected the TRNC trade. The production costs and exports prices increased. Therefore the competition power of domestic production is lost. As a result of this the imports of TRNC were always high. It is not wrong to say that the trade of TRNC based on imports, distribution and retail business.

The foreign trade balance of TRNC can be seen in Table 1.9. The increase of foreign trade gap is shown on Graph 1.41. As it is seen the gap was -374.5 million USD. The Tourism and Universities revenues do not close this gap.<sup>39</sup>

<sup>38</sup> TRNC Prime Ministry, SPO, *Op.cit.*, pp. 2-3

<sup>39</sup> Ekonomiden Sorumlu Devlet Bakanlığı ve Başbakan Yardımcılığı, Ticaret Dairesi, *Op.cit.*, 270 - 277

### 1.3.3.3 Net Tourism Revenues

Net tourism revenue of TRNC was 30.2 million USD in the year 1977 and after 24 years it became 198.3 million USD in the year 2000. (Table 1.9)<sup>40</sup>

The increase in net tourism revenue was 6.56 times during this period of 24 years. As it is said in sectoral analysis of tourism, (Sec.1.3.2.3.) tourism has selected as preferential, locomotive sector of TRNC. Tourism was expected to carry all the TRNC economy. As it can be seen from the Table 1.9, the net tourism revenues were never enough to close the foreign trade gap of TRNC. The change of net tourism revenues, during this period, can be seen from the Graph 1.40. In the period between 1977 and 1986 the increase of net tourism revenues were very slow. The net tourism revenue of TRNC became 52 million USD in the year 1986. After 1986 there was a relatively better growth in the net tourism revenue of TRNC. This increase was because of the increased supports to the tourism sector. The peak was in the year 1993 and the net tourism revenue was 224.6 million USD.

The period of the rapid growth was the period when the new hotels were built and when some Turkish airline companies started to fly to TRNC. After 1993, there was a rapid drop in the net tourism revenues of TRNC. (Graph. 1.40) The net tourism revenues of TRNC were 175.6 million USD in the year 1996. The terrorism and internal instability of Turkey affected negatively to the tourism of Turkey and TRNC. Many Turkish airlines companies were shut down. Therefore the number of flights to TRNC decreased. Also the Iraq crisis in the region affected negatively to the tourism sector of TRNC.

After 1996 there was a small increase in net tourism revenues of TRNC. As a result of this analysis, the net tourism revenue of TRNC was not satisfactory. Therefore tourism never carried the other sectors of TRNC economy, but tourism itself always needed some supports form governments.

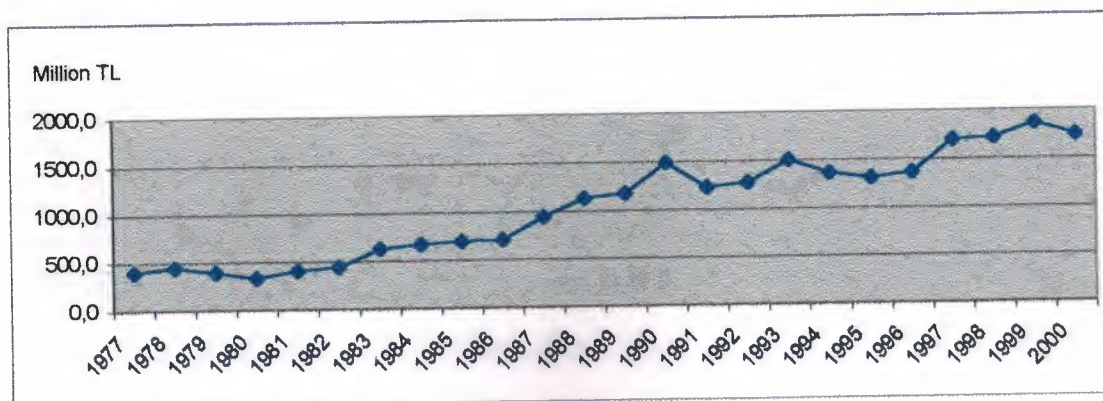
<sup>40</sup> TRNC Prime Ministry, SPO, *Op. cit.*, pp. 2-3

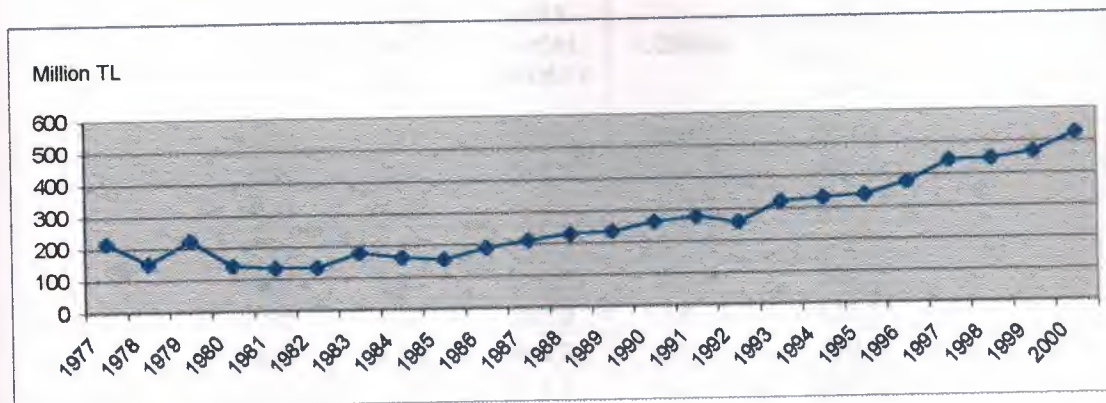


**Table 1.10: Balance of State Revenues (1977 prices million TL)**

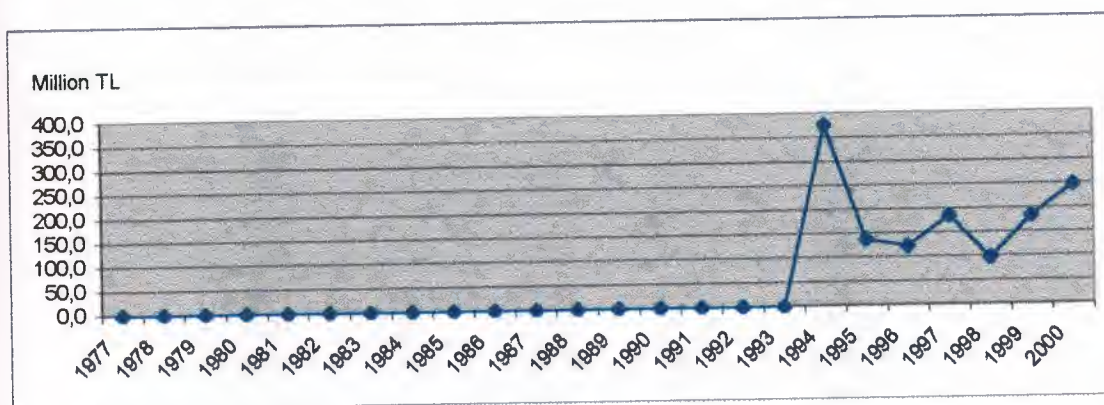
YEAR	TAX REVENUES	OTHER INCOMES	FUND REVENUES	TOTAL LOCAL REVENUES
1977	408,0	219,7	0,0	627,7
1978	456,4	153,9	0,0	610,3
1979	403,6	224,0	0,0	627,6
1980	338,5	144,0	0,0	482,5
1981	415,4	137,4	0,0	552,8
1982	446,5	136,9	0,0	583,4
1983	634,6	180,9	0,0	815,5
1984	676,1	164,9	0,0	841,0
1985	704,0	156,8	0,0	860,8
1986	718,3	189,7	0,0	908,6
1987	948,6	212,1	0,0	1160,7
1988	1135,9	231,3	0,0	1367,2
1989	1182,6	237,7	0,0	1420,3
1990	1495,4	264,2	0,0	1759,6
1991	1237,2	279,1	0,0	1516,3
1992	1285,9	261,5	0,0	1547,4
1993	1514,0	323,1	0,0	1837,1
1994	1371,6	332,3	377,6	2081,5
1995	1314,9	341,1	138,2	1794,2
1996	1371,9	378,8	123,5	1874,2
1997	1704,3	444,9	185,5	2334,7
1998	1728,9	449,4	97,6	2275,9
1999	1874,2	469,1	184,9	2528,2
2000	1753,5	527	248,8	2529,3

Source: TRNC Prime Ministry, SPO, Economic and Social Indicators 2000

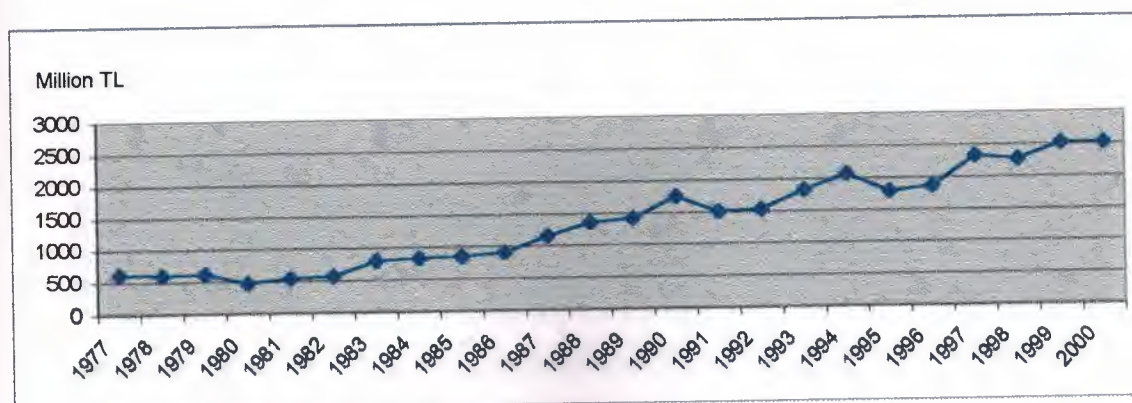
**Graph 1.42: Tax Revenues of TRNC (1977 prices million TL)**



**Graph 1.43: Other Incomes of TRNC (1977 prc)**



**Graph 1.44: Fund Revenues of TRNC (1977 prc)**



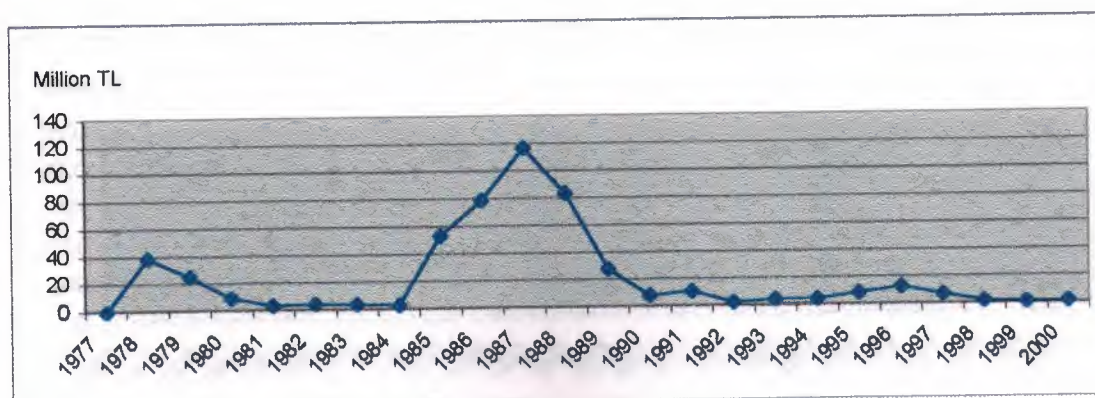
**Graph 1.45: Total Local Revenues of TRNC (1977 prc)**



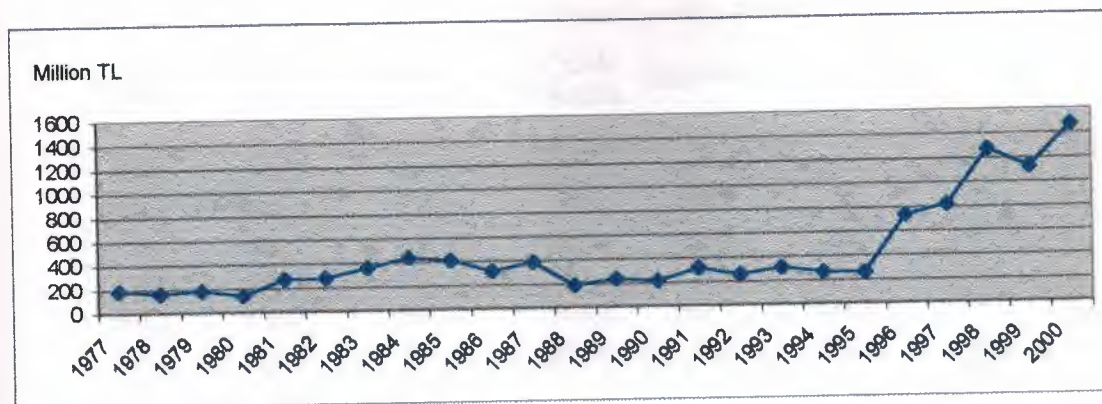
**Table 1.11: Balance of Foreign Aids and Loans of TRNC (1977 prices million TL)**

YEAR	OTHER FORING AIDS	AIDS FROM TURKEY	LOANS	TOTAL FOREIGN AIDS AND LOANS
1977	0.0	193,6	364,8	558,4
1978	39	168,3	277,7	485,0
1979	25,20	185,2	347,3	557,7
1980	9,50	146,9	380,6	537,0
1981	3,90	275,7	324,4	604,0
1982	4,80	286,2	365,6	656,6
1983	4,40	364,9	351,4	720,7
1984	3,40	444,9	433,9	882,2
1985	53,50	418,5	500,7	972,7
1986	79,30	319,3	616,2	1014,8
1987	117,20	392,1	415,2	924,5
1988	83,60	193,5	242,8	519,9
1989	28,20	241,6	175,6	445,4
1990	8,60	220,8	376,6	606,0
1991	11,40	318,9	742,4	1072,7
1992	2,60	263,3	602,9	868,8
1993	4,80	317,4	563,7	885,9
1994	4,70	272,3	385,7	662,7
1995	8,70	265,8	826,2	1100,7
1996	12,90	738,6	316,9	1068,4
1997	7,40	826,4	237,3	1071,1
1998	2,20	1278,6	281,6	1562,4
1999	1,40	1134,6	627,8	1763,8
2000	1,80	1482,3	596,3	2080,4

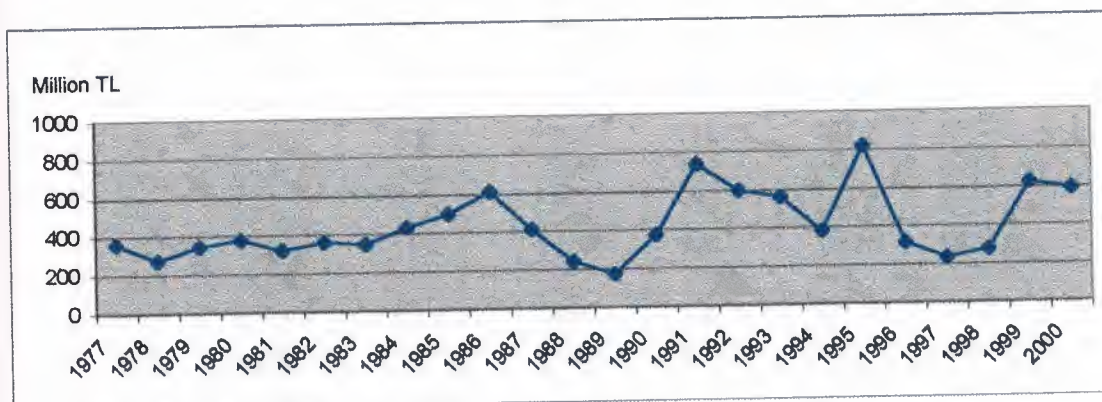
Source: TRNC Prime Ministry, SPO, Economic and Social Indicators 2000



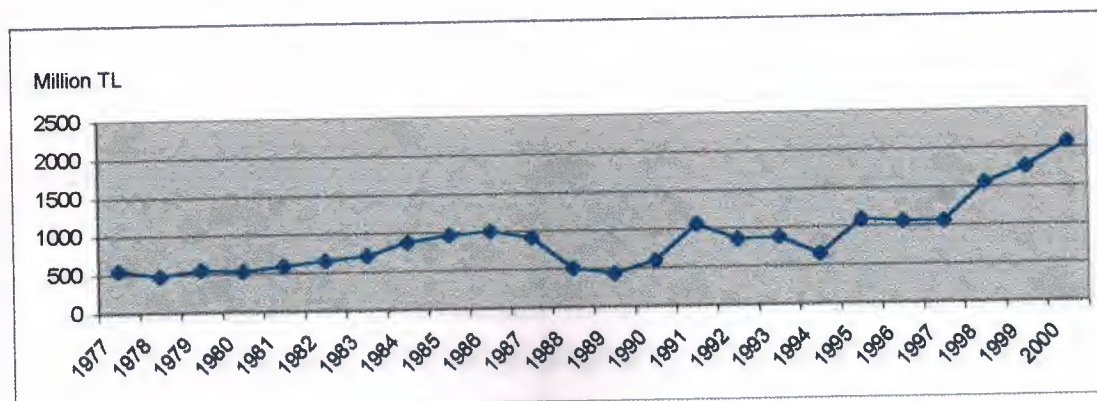
**Graph 1.46: Other Foreign Aids of TRNC (1977 prices million TL)**



**Graph 1.47: Aids from Turkey to TRNC (1977 pr**



**Graph 1.48: Loans of TRNC (1977 prc)**



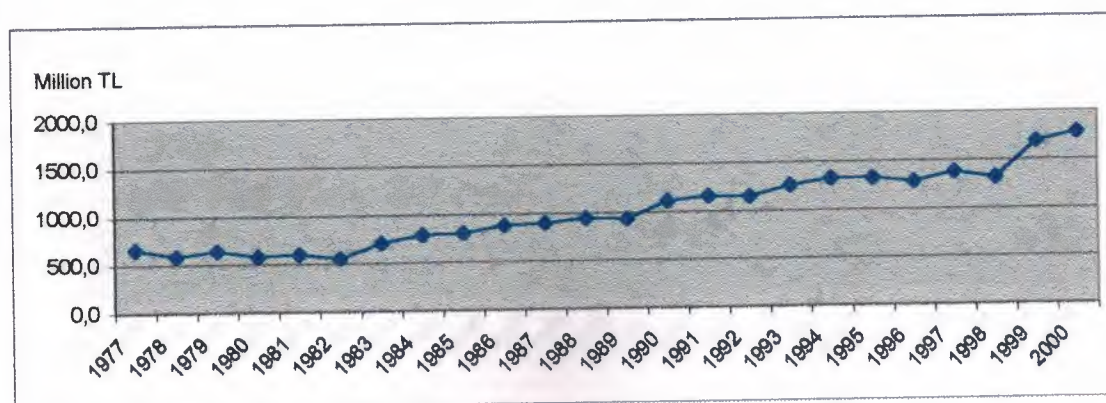
**Graph 1.49: Total Foreign Aids and Loans of TRNC (1977 prs)**



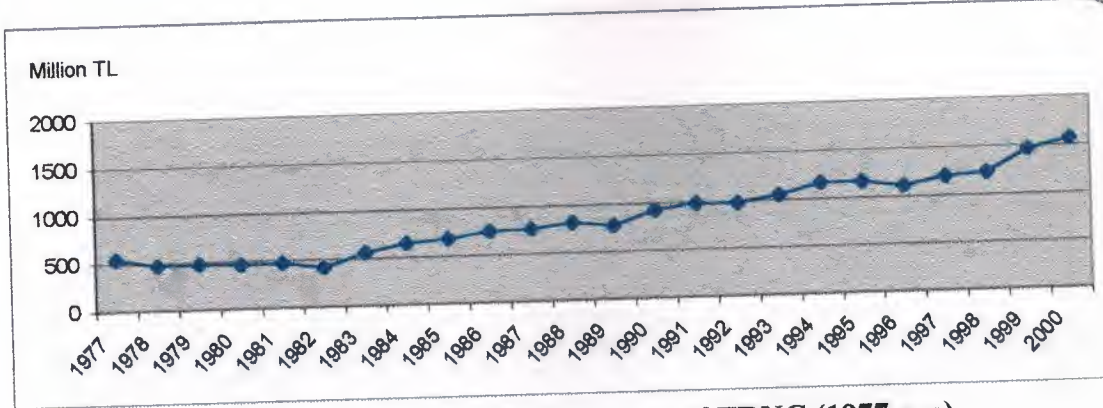
Table 1.12 Balance of State Expenditures of TRNC (1977 prices Million TL)

YEAR	CURRENT EXPEND	PERSONNEL EXPEND.	SOCIAL TRANS.	DEFENCE	INVESTM.	TOTAL EXPEND.
1977	668,0	553,3	0,0	143,6	90,8	1186,1
1978	592,6	478,5	0,0	95,3	97,1	1095,3
1979	650,7	490,9	227,6	98,5	69,2	1185,3
1980	586,6	477,4	163,4	78,9	96,4	1019,5
1981	608,1	482,6	198,5	87,9	188,7	1156,8
1982	563,2	418,7	287,6	97,0	208,9	1240,0
1983	715,1	569,4	317,1	119,1	248,8	1536,2
1984	793,1	655,8	324,8	162,2	260,7	1723,2
1985	807,5	689,9	413,9	144,1	259,8	1833,5
1986	884,5	755,1	425,4	135,9	205,8	1922,8
1987	903,8	767,6	497,7	117,6	317,6	2085,2
1988	950,5	822,3	459,3	107,2	138,1	1887,1
1989	936,8	784,3	466,3	91,0	216,9	1865,7
1990	1116,4	932,9	653,0	90,8	335,4	2365,6
1991	1162,7	993,0	673,1	136,5	326,6	2589,0
1992	1155,1	984,1	703,8	148,5	237,0	2416,2
1993	1264,0	1058,8	754,5	137,1	342,1	2723,0
1994	1331,6	1170,1	798,3	136,0	266,9	2744,2
1995	1327,8	1168,0	1060,6	158,5	180,3	2894,9
1996	1288,0	1119,6	927,2	150,6	313,1	2942,6
1997	1383,4	1205,7	946,9	293,7	414,2	3405,8
1998	1326,9	1234,9	1020,9	398,7	520,7	3838,3
1999	1696,2	1469,3	1120,8	500,7	440,0	4292,0
2000	1791,6	1568,6	1233	336,8	501,4	4609,7

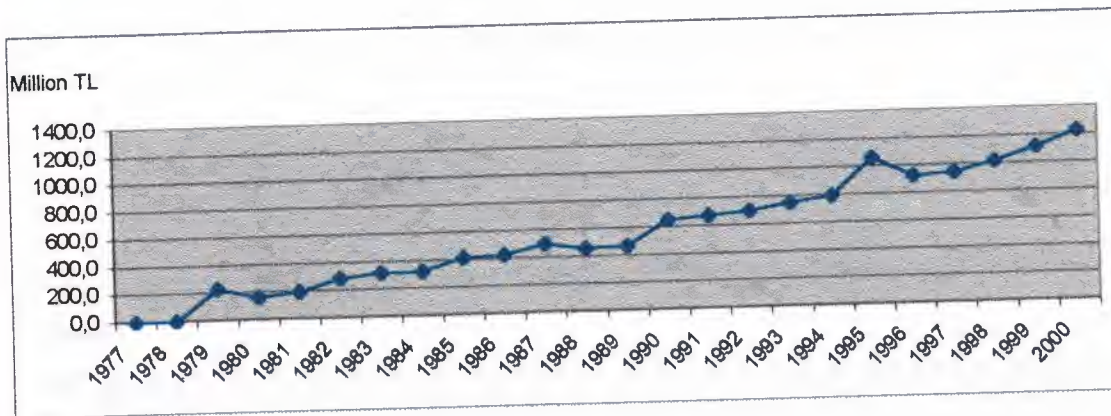
Source: TRNC Prime Ministry, SPO, Economic and Social Indicators 2000



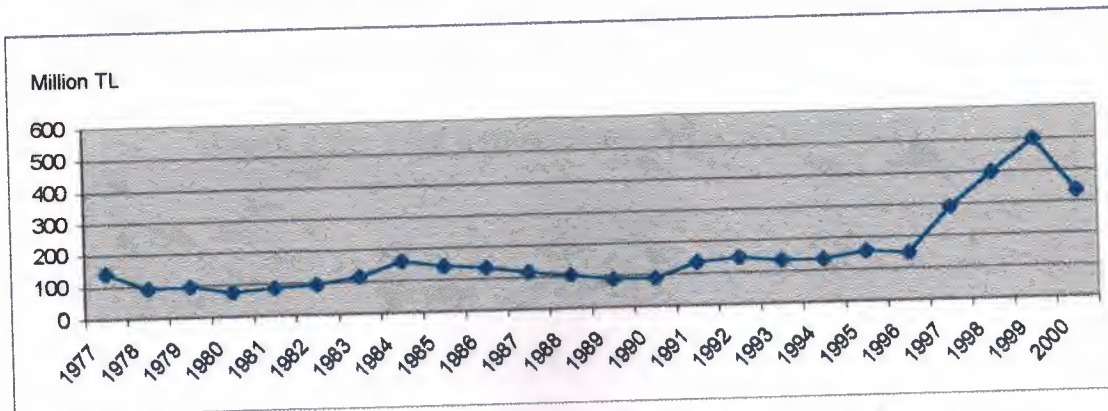
Graph 1.50: Current Expenditures of TRNC (1977prc)



**Graph 1.51: Personnel Expenditures of TRNC (1977 prc)**

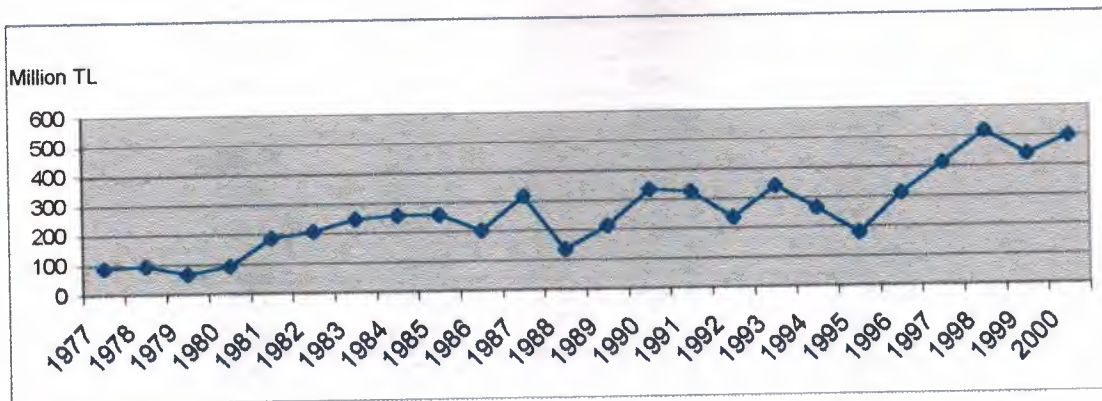


**Graph 1.52: Social Transfers of TRNC (1977 prc)**

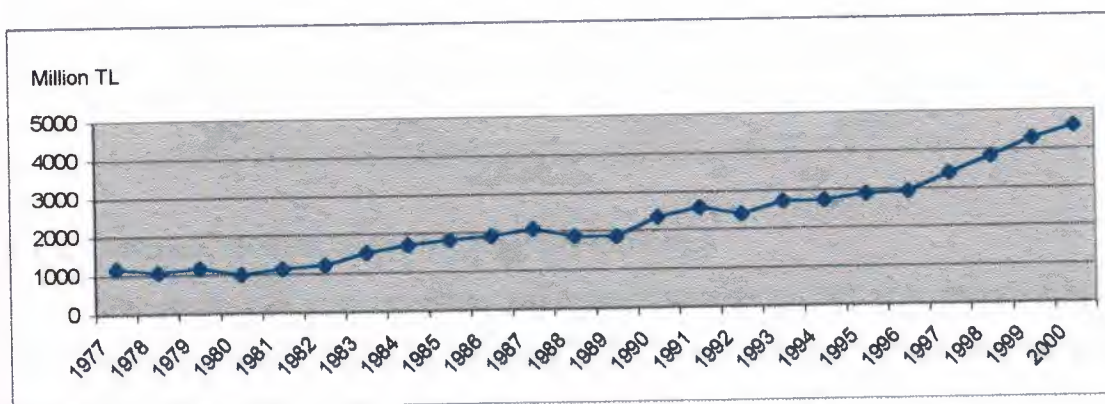


**Graph 1.53: Defense Expenditures of TRNC (1977 prc)**





**Graph 1.54: Investments of TRNC (1977 prc)**



**Graph 1.55: Total Expenditures of TRNC (1977 prc)**

**Table 1. 13: Balance of State Revenues and Expenditures of TRNC**  
(1977 prices Million TL)

YEAR	TOTAL LOCAL REVENUES	TOTAL FOREIGN AIDS AND LOANS	TOTAL EXPEND.
1977	627,7	558,4	1186,1
1978	610,3	485,0	1095,3
1979	627,6	557,7	1185,3
1980	482,5	537,0	1019,5
1981	552,8	604,0	1156,8
1982	583,4	656,6	1240,0
1983	815,5	720,7	1536,2
1984	841,0	882,2	1723,2
1985	860,8	972,7	1833,5
1986	908,6	1014,8	1922,8
1987	1160,7	924,5	2085,2
1988	1367,2	519,9	1887,1
1989	1420,3	445,4	1865,7
1990	1759,6	606,0	2365,6
1991	1516,3	1072,7	2589,0
1992	1547,4	868,8	2416,2
1993	1837,1	885,9	2723,0
1994	2081,5	662,7	2744,2
1995	1794,2	1100,7	2894,9
1996	1874,2	1068,4	2942,6
1997	2334,7	1071,1	3405,8
1998	2275,9	1562,4	3838,3
1999	2528,2	1763,8	4292,0
2000	2529,3	2080,4	4609,7

Source: TRNC Prime Ministry, SPO, Economic and Social Indicators 2000

#### 1.3.4. Analysis of State Revenues and Expenditures

The analysis of state revenues and expenditures shows that, the expenditures of TRNC never covered by the state revenues. TRNC every year got foreign aids and loans about 40% of the total state expenditures. In the year 1977 TRNC got 47% of her total state expenditures as foreign aids and loans. (Table 1.13)<sup>41</sup> This ratio was 45% in the year 2000. The lowest level of this ratio was 23% in the year 1989. The source of these foreign aids was Turkey. Also the loans were obtained from Turkey and never paid back. Therefore these loans have to be treated as aids from Turkey.

<sup>41</sup> TRNC Prime Ministry, SPO, Economic and Social Indicators 2000, pp. 42-43



#### 1.3.4.1 Local Revenues.

The tax revenues of TRNC were 408.0 million TL and the other incomes of TRNC were 219.7 million TL, so the total revenues of government in the year 1977 were 627.7 million TL (Table 1.10) The tax revenues of TRNC in 2000 were 753.5 million TL, other incomes were 527 million TL, fund revenues were 248.8 million TL, hence totally the revenues of the government were 2529.3 million TL with constant prices of 1977.<sup>42</sup>

The tax revenues of TRNC increased 4.20 times during the period of 24 years starting from 1977 and ending at 2000. The change in tax revenues of TRNC can be seen from the Graph 1.42. The tax revenues dropped in the crisis years of TRNC, related to the crisis in Turkish economy (1980, 1991, 1995, 2000)

Total local revenues of TRNC increased 4.02 times during the period. The drop in the total local revenues was because the incomes other than taxes of TRNC didn't increase with the same rate as the tax revenues. The change of the income of TRNC other than taxes is shown on Graph 1.43

TRNC government had fund revenues starting from the year 1994. (Table 1.10) The fund revenues were 377.6 million TL in the starting year and after that year it was in between 138.2 million and 248.8 million TL with constant prices of 1977, in the period starting from 1995 and ending at 2000. (Graph 1.44) The change of the total state local revenues of TRNC during this period is plotted on the Graph 1.45.

TRNC covered 53% of its expenditures with her local revenues in the year 1977. This ratio was 54% in the year 2000. (Table 1.14) In other words TRNC spent about twice then its revenues. It is not possible for any state to survive with so big gap between the revenues and expenditures. TRNC is the unique state that manages to survive with this gap, because always the gap between the revenues and expenditures of TRNC has been covered by the aids from Turkey.

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<sup>42</sup> Ibid.

### 1.3.4.2 Foreign Aids and Loans

TRNC had big amounts of foreign aids. The aids came mainly from Turkey. Only very small amount of foreign aids came from other resources. The amounts of foreign aids that TRNC received from other resources than Turkey is shown in the first column of Table 1.11.<sup>43</sup> The other foreign aids are shown on Graph 1.46. The amounts of other foreign aids in the years 1978, 1979 and in the period 1985 – 1989 were considerable. The amounts other foreign aids of other years were negligible.

The aids from Turkey started with 193.6 million TL in the year 1977. It decreased to 146.9 TL in the year 1980. Then it increased gradually and became 1482.3 million TL in the year 2000, with the constant prices of 1977. (Table 1.11) The variation of the aids from Turkey is shown on Graph 1.47. It can be seen from this graph that, from 1995 onwards there is a dramatic increase in aids from Turkey. These years were the starting years of stagflation in TRNC. From 1994 onwards TRNC had high inflation and recession together. TRNC had negative growth rate of GNP in the year 1994 and very small growth rates in the subsequent years. (Table 1.1)

The aids from Turkey were 30% of total local revenues in the year 1977. Although the amount of aids from Turkey decreased the ratio to the total local revenues was same namely 30% in the year 1980. The ratio became 56% in the year 1998 and it was 58% in the year 2000 at the end of the period. This analysis shows that, Turkey always covered the deficits of TRNC governments.

Besides foreign aids, TRNC got loans from Turkey. Although these loans from Turkey were shown as loans actually these loans never paid back. After a certain period these loans cancelled by Turkey. Therefore these loans were practically also aids from Turkey.

In the year 1977, TRNC got 364.8 million TL from Turkey and in the year 2000 the loans were 596.3 million TL with constant prices of 1977. (Table 1.11) The change of the loans from Turkey is shown on Graph 1.48

<sup>43</sup> Ibid.



The total foreign aids and loans are shown in the last column of Table 1.11. TRNC got 558.4 million TL in the year 1977. In the year 2000 TRNC got 2080.4 million TL foreign aids and loans with the constant prices of 1977. The change in the total foreign aids and loans during this period can be seen on Graph 1.49. The total foreign aids and loans were minimum in the year 1989 with 445.4 million TL. The total aids and loans from Turkey increased dramatically from 1994 on. The total foreign aids and loans from Turkey were 88% of the total local revenues in 1977. In 1989 this ratio decreased to 31%, which was the minimum. Then it increased again and it was 82% in the year 2000, at the end of the period.

These analysis shows that during this period TRNC got as much as necessary aids from Turkey to cover the twin deficits of TRNC. This was the only reason of why TRNC had no payment problems.

#### 1.3.4.3. State Expenditures

Current expenditures of TRNC were 668.0 million TL in the year 1977. The current expenditures of TRNC increased to 1791.6 million TL in 2000 with the constant prices of 1977. (Table 1.12)<sup>44</sup> The current expenditures increased 2.68 times during the period from 1977 to 2000. The change of current expenditures during the period is shown on Graph 1.50.

The tax revenue of TRNC was hardly enough to cover the current expenditures of TRNC. In the year 1977 tax revenues were 61% of the current expenditures. In the year 2000 the tax revenues was 1753.5 million TL while the current expenditures were 1791.6 TL with the constant prices of 1977.

The personal expenditures of TRNC were 553.3 million TL in the year 1977. There was a decrease in the personal expenditure until 1982. In the year 1982 the personal expenditure of TRNC was minimum namely 418.7 million TL with the prices of 1977. (Table 1.12) After 1982 personal expenditure of TRNC gradually increased. In the year 2000 it was 1568.6 million TL. In other words, the personal expenditure of

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<sup>44</sup> Ibid.

TRNC increased 2.83 times during the period of 24 years from 1977 to 2000. (Graph 1.51)

If the personal expenditures and total revenues of TRNC are compared; in the year 1977 the personal working in public services received 88% of the total local revenues of TRNC. This ratio was 71.5% in the year 1982 and it was 62% in the year 2000. This analysis shows that, the personal expenditures of TRNC were always high and a big portion of government revenues always gone to the public servants.

In the first two years of the period (1977 – 1978) TRNC had no social transfers. In the year 1979 TRNC had 227.6 million TL social transfers (Table 1.12)<sup>45</sup> starting from 1982 the social transfers increased every years. In the year 2000 it was 1233.0 million TL with constant prices of 1977. The big portion of the social transfers (More than 95%) is the transfer payments to retired civil servants. In the year 2000, 70% of tax revenues were transferred to the retired civil servants. The fund, which transferred to retired civil servants in TRNC, were always too big. The laws of TRNC gave opportunity to the civil servants to retire in very early ages. Also according to the laws of TRNC, the transfer payments to retired people are free of tax. The rapid and continuous increase of social transfers can be seen from Graph 1.52.

Defense expenditures of TRNC was 143.6 million TL in the year 1977, it decreased to 78.9 million TL in the year 1980 and then increased to 336.8 million TL in the year 2000 with the constant prices of 1977. (Table 1.12) The changes of defense expenditures of TRNC is plotted on the Graph 1.53. Turkey defends TRNC. Turkish troops are located in TRNC. The expenditures for the defense of TRNC were more then the given figures in Table 1.12. The given figures in that table are the contribution of TRNC government to the defense of TRNC.

The government investments of TRNC was 90.8 million TL in the year 1977<sup>46</sup>, it was 69.2 million in the year 1979 which was the minimum and the maximum investment of the government of this period was 520.7 million TL in the year 1998,

<sup>45</sup> Ibid.

<sup>46</sup> Ibid.



with the constant prices of 1977. (Table 1.12) In the year 2000 at the end of the period, the government investments were 501.4 million TL with the constant prices of 1977. The analysis of Table 1.12 shows that, the current expenditures personnel expenditures and social transfers were the biggest items of the expenditures of TRNC. Therefore TRNC did not have enough funds to invest on the infrastructures. The infrastructures investment of TRNC has been financed directly from Turkey.

The big gap between the government revenues and expenditures can be seen, by comparing the total state revenues of TRNC with the total state expenditures. In the year 1977 the government expenditures were 189% of the government revenues and the ratio was 182% in the year 2000<sup>47</sup>. These ratios show the internal deficits of TRNC economy. The foreign trade deficit. (Section 1.3.3) and budget deficit shows the weaknesses and instability of TRNC economy.

### 1.3.5 Chapter Conclusion

This chapter was devoted to the retrospective analysis of TRNC economy. The analysis based on data of economic and social indicators 2000 published by the State Planning Organization of TRNC.

The sectoral developments of TRNC economy are examined and results show that the development processes were not satisfactory. Only the growth of the universities (Business and Service sector) was satisfactory. The analysis of foreign trade indicators showed the external deficits of TRNC. The analysis of the state revenues and expenditures showed the deficits of the TRNC budget.

The weakness of TRNC economy is obvious from this retrospective analysis. The TRNC economy has been carried by the Turkish economy. While the economic activities in TRNC took place with the aids from Turkey the volatility of Turkish economy affected TRNC economy. The economic development of TRNC definitely was not satisfactory. Without radical changes in the economic structure of TRNC development cannot be achieved.

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<sup>47</sup> Ibid.

The economy of TRNC shows all characteristics of small island economies. Before working on any development strategy, next chapter is devoted to the theoretical base of the characteristics of small island economies, and also economic development and economic development strategies.



2. The population of the island was 200,000 in 1950. During the common economic growth period, the population grew to 300,000 in 1970. The common economic growth period was from 1950 to 1970. The population growth was 50% during this period. The population growth was 50% during this period.

## CHAPTER II

The growth of the island economy was 50% during the common economic growth period. The growth of the island economy was 50% during the common economic growth period.

### SMALL

### ISLAND ECONOMIES

### AND

### ECONOMIC DEVELOPMENT

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## 2.1 SMALL ISLAND ECONOMIES

TRNC is a small island country. Population was 200,587 according to 1996 census<sup>48</sup>. Therefore TRNC is facing the common economic problems of small island economies. Small island economies have been facing similar economic problems, such as scale diseconomy in all dimensions of economic activities, over dependency on external trade and assistance, high costs of transportation. All island economies however have experienced painful trial – and error efforts to achieve self-reliant economic development.<sup>49</sup>

This section is devoted to a brief analysis of most important vulnerabilities of Small Island Developing States (SIDS).<sup>50</sup> Also the effects of these vulnerabilities on TRNC economy are discussed.

There is no single definition of small country, because size is a relative concept. For instance, Simon Kuznets in 'Economic Growth of Small Nations' used an upper limit of 10 million people. Commonwealth in its work on small states, used a threshold of 1.5 million people. Other indicators such as territory size, or GDP are sometimes used. Using the standard of population and territory size, TRNC is a SIDS. The main disadvantages of SIDS are given below<sup>51</sup>.

### 2.1.1 Small Size

As their term implies, smallness is a characteristic of SIDS. Small size is economically disadvantageous for a number of reasons.

#### a-) Limited Natural Resource Endowments and high Import Contents

Small size implies poor natural resource endowments and low inter-industry linkages, which results in relatively high import content in relation to GDP.

<sup>48</sup> TRNC Prime Ministry, SPO, **Census of Population Social and Economic Characteristics of Population December 15, 1996**, Ankara, Devlet Statistic Enstitüsü Matbaası, 1999, p: 6

<sup>49</sup> Hiroshi Kakazu, **Sustainable Development of Small Island Economies**, Oxford, Westview Press, 1994, pp: 4-5

<sup>50</sup> World Bank, **Small States, Meeting Challenges in Global Economy**, Report of the Commonwealth Secretariat, Joint Task Force on Small States, Washington DC and London 2000, pp: 3-15

<sup>51</sup> Lino Briguglio, **Small Island Developing States and Their Economic Vulnerabilities**, <http://www.geic.or.jp/islands/docs/lino.html>, pp: 13-18



TRNC is very poor as related with natural resource endowment. TRNC do not have any natural mineral resources and the water resources are very scarce. Additional water has been brought from Turkey for domestic usage purposes. TRNC is an import dependent country. Exports of TRNC were 50.4 million USD and the imports of TRNC were 424.9 million USD in the year 2000. Exports of TRNC are gradually decreasing while imports of TRNC are gradually increasing. (Table 1.9)<sup>52</sup>

### **b-) Limitations on Import Substitution Possibilities**

The small size of the domestic market, severely limits imports substitution possibilities. In many SIDS where import substitution policies were adopted, the result tended to be a protected environment with inferior quality products, higher prices and parallel market of no domestically produced goods.

TRNC does not have any import substitution policy, but the domestic industrial products are protected by customs barriers, up to a certain level. Table 2.1 shows the total protection of some domestic industrial products.<sup>53</sup>

**Table 2.1 Customs Barriers of Some Domestic Industrial Products of TRNC**

Biscuits	18.5% Total Customs Protection
Chocolates	42.0%
Potatoes Chips	28.0%
Cleaning Detergents	42.0%

Source: Chamber of Industry of TRNC

TRNC has two parallel markets in those goods, which are domestically produced. First market is the relatively low priced domestic products market and the second market is the relatively high priced imported goods market.

### **c-) Small Domestic Market and Dependence of Export Markets**

The small domestic market and the need for a relatively large amount of foreign exchange to pay for the import bills, gives rise to a relatively high dependence on

<sup>52</sup> TRNC Prime Ministry, SPO, *Economic and Social Indicators 2000*, pp: 2-3

<sup>53</sup> *KKTC Gümrük Vergileri Tarife Yasası (Yasa No: 44/96)*, Resmi Gazete, Sayı 104, 19 Ağustos 1999, pp: 947,956,961,1138

exports and therefore on economic conditions in the exports market. Limited market size often results in a lack of competition. As a result, the economies of small states do not benefit from the effects of competition on improving efficiency, lowering costs and adoption of new technology. There isn't enough competition neither in imported goods market nor in the domestic product market. Since the domestic market size is too small, there are limited number of importers in all imported goods and also there are only a few producers who are producing the same domestic products.

The result of the embargoes is the increase in the price of TRNC exported goods. Therefore the exports of TRNC are very limited. (Table 1.9) The exports and imports are mainly with Turkey. Therefore there is a big foreign trade gap between TRNC and Turkey. This implies that TRNC is highly dependent to the economic conditions of Turkey.

#### **d-) Dependence on a Narrow Range of Products**

In many cases, small size restricts the county's ability to diversify its exports. This carries with it, the disadvantage associated with having too many eggs in one basket.<sup>54</sup> TRNC has only a few industrial or agricultural products for export. The main foreign currency input of TRNC is from higher education and tourism sector. (Table 1.9)

#### **e-) Limited Ability to Influence Domestic Prices**

SIDS have negligible control on the prices of the products that they export and import. All developing countries are to an extent price takers, but SIDS tend to be price takers to a much higher degree due to the relatively very small volume of trade.<sup>55</sup> TRNC is a price taker country both in exports and imports. This gives upward pressure to the market prices.

#### **f-) Limited Ability to Exploit Economies of Scale**

Small size renders it difficult for SIDS to exploit the advantages of economies of scale, mostly due to indivisibility and limited scope for specialization. In turns this

<sup>54</sup> World Bank, *op.cit.*, p.10

<sup>55</sup> Kakazu, *op.cit.*, p.5



gives high per unit costs of production, high costs of infrastructure construction and utilization per capita, high per unit costs of training specialized manpower, and high degree of dependence on imported technologies.

The production costs of TRNC are very high, because of diseconomies of scale. The producers have to keep high stock levels in order to ensure the smoothness of the production. To find skilled labor for any type of production is always a big problem while on the other hand it is always possible to find unemployed different kind of skilled labor. The diseconomies of smallness and the embargoes affect the production of TRNC and gives upward pressure to the production costs.

### **2.1.2 Insularity and Remoteness**

As there terms implies, one of the main characteristic of SIDS is remoteness and isolation. SIDS are far from the main lands and isolated. Isolation means that, these countries are far from the major centers of trade and commerce.<sup>56</sup>

TRNC is only 40 miles from Turkey. Therefore TRNC is not remote like most of the SIDS in the Pacific region. On the other hand TRNC is isolated because of the non-recognition, embargoes and the limited transportation capacity. The effects of the remoteness and isolation on the economies of SIDS can be explained as follows.

#### **A-) The per unit Transportation Costs of SIDS are high**

Small economy requires relatively small and fragmented cargoes, leading to high per unit costs. High international transport costs serve to increase the costs of exports and reducing their competitiveness. Similarly the costs of imports are increased, resulting in consumer welfare losses.

The per unit transportation costs of TRNC imports, increases the prices of imported goods. As a result of the embargoes, TRNC is excluded from the major sea and air transport roots, which causes delays and other transportation constraints. This affects the tourism business of TRNC. There is not any direct flight to TRNC; hence all the flights to and from TRNC have to touchdown to any Turkish airport. This increases

<sup>56</sup> Briguglio, *op.cit.*, p: 16

the input costs of the tourism sector. On the other hand, the high per unit transportation costs of TRNC export cargoes, puts barrier to the exports of TRNC.

### **b-) Uncertainties of Supply**

Apart from the high per unit cost of transport, insularity from main commercial centers may also give rise to additional problems, such as time delays and unreliability in transport services.

TRNC has, time delays and reliability problems both in cargo and human transportation. The size of export cargoes of TRNC and the uncertainty and the delays in sea transport resulted with expensive airfreight cargo transportation in exports of TRNC. Which affects negatively the exports of TRNC.

### **c-) Large Stocks**

An additional problem is that, when transport is not frequent and regular, the companies in SIDS have to keep large stocks. This implies, additional costs associated with tied up capital, rent of warehousing and wages of storekeepers.

The producers of TRNC have to keep large stock levels to ensure smooth production, which is again an extra cost element on top of TRNC products. The diseconomy of smallness, the isolations and the high transportation costs are the main reasons of lack of production in TRNC.

## **2.1.3 Access to External Capital**

SIDS have an excessive degree of dependence on foreign sources of finance, including remittance from migrants and development assistance from donor countries. The problems of access to external capital can be explain as follows<sup>57</sup>:

### **a-) Access to Private Finance**

Turning to the private finance flows, many SIDS are limited in their access to commercial borrowing. Private markets and credit rating agencies also take account of

<sup>57</sup> Michael Bowe, Lino Briguglio, James W. Dean, **Banking and Finance in Islands and Small States**, Biddles Ltd, 1998, pp: 10-15



the greater vulnerability and volatility of small states. Therefore, the integration of SIDS with the international financial and capital markets is more costly and narrow than desirable.

As a result of the embargoes and no recognition TRNC do not have any contact with the international finance markets. Therefore TRNC gets high amount of financial aid from Turkey.

### **b-) Foreign Direct Investment (FDI)**

FDI's brings not only capital but is often critical in linking the more isolated small states to developments abroad. Foreign firms can be an important source of know-how for improving private sector capacity and of information on new technologies and market opportunities. SIDS are at a disadvantage in attracting FDI relative to other countries. Even when they have good policies and other characteristics small states are treated to be significantly more risky.

Cyprus problem is not yet settled. TRNC is not a recognized country, and also the embargoes increase the risks of TRNC. Therefore FDI's in TRNC is very limited.

### **2.1.4 Limited Institutional Capacity**

Sovereignty implies the provision of range of public goods and services. These include the central functions of government, regulatory activities, tax administration, provision of education, health and social services, a judicial system, foreign relations and security. The fixed costs of these services must be spread among the population.<sup>58</sup>

### **a-) Problems of Public Administration**

Small size creates problems associated with public administration. The most important of which is probably a small manpower resource base from which to draw experienced and efficient administrators. Very often many specialists originating from SIDS decide immigrate to larger countries where their services are better utilized. Which shows that the SIDS have brain drain.

<sup>58</sup> World Bank, *op.cit.*, p:17

Many well-educated, highly skilled Turkish Cypriots are leaving for other countries. The students from TRNC who have university education and post-graduate study in other countries find better opportunities in the big countries and do not return to the TRNC. Also the job facilities of TRNC are very limited hence it is not possible to offer job opportunity for all the university graduates. The number of students who had university education in the academic year of 1999 – 2000 is shown in the Table 2.2.<sup>59</sup>

**Table 2.2 Students Who Had University Education  
In The Academic Year 1999 – 2000**

TRNC Universities	6644 students
Turkish Universities	1882 students
Universities of UK	211 students
Universities of USA	173 students
Universities of Other Countries	28 students
<b>TOTAL</b>	<b>8938</b>

Source: TRNC Prime Ministry, SPO, Statistical Yearbook 2000

The total number of employment of TRNC in the year 2000 was 89327. Therefore the percentage of the university students to the total employment was 10%. In the year 2000. (Table 2.3)<sup>60</sup>

Government functions tend to be very expensive per capita when the population is small, due to the fact that certain expenses are not divisible in proportion to the number of users. Another public administration problem in SIDS is that people know each other well, and are often related to each other. This tends to work against impartiality and efficiency in the civil service and against a merit-based recruitment and promotion policy.

Many people are employed in the public administration of TRNC. Therefore, cost of public administration is very high, which gives upward pressure to the prices of

<sup>59</sup> TRNC Prime Ministry, SPO, **Statistical Yearbook 2000**, Nicosia, State Printing House, March 2002, pp: 78-80

<sup>60</sup> TRNC Prime Ministry, SPO, **Economic and Social Indicators 2000**, pp: 70-71



the domestic products. As a result of the over employment in the public administration of TRNC, the efficiency of the civil servants of TRNC is very low. Instead of merit-based promotions, political choices and family-based choices take place in the TRNC.

**Table 2.3 Sectoral Distribution of Employment in TRNC Year 2000**

Name of the Sector	No. Of Employment	Percent of Employment
Agriculture	15236	17.1%
Industry	8715	9.7
Construction	14104	15.8
Trade and Tourism	9630	10.8
Transport / Communication	8104	9.1
Financial Institutions	2397	2.7
Business&Personel Services	13057	14.6
Public Services	18084	20.2
<b>Total Employment</b>	<b>89327</b>	<b>100</b>

Source: TRNC Prime Ministry, SPO, Economic and Social Indicators 2000,

### **b-) Problems of Private Sector**

Most firms in small states are small in scale. Small domestic markets and poor endowments of physical resources limit the entrepreneurial opportunities.<sup>61</sup> Small firms have disadvantage because they cannot realize economies of scale. They are not attractive business partners, and they cannot spend significant funds on marketing, market intelligence and research and development. Small size and isolations limit development of new knowledge and technology oriented to the domestic market. Moreover small firms in small states are often nevertheless monopolies or oligopolies, in terms of the local market, without the advantages of the spur of local competition. Regulating local monopolies is often too great challenge for a thinly spread administration. Moreover, the task can be made more difficult in some very small states when the regulators and the regulated are from the same family or from the same political party, or childhood friends, or where the local monopoly is owned by a large and powerful overseas investor.

<sup>61</sup> World Bank, *op.cit.*, pp: 46-47

**Table 2.4 The scale of The Firms of TRNC Based on The Number of Employees  
(Year 1998)**

Number of Employees	Number of Firms
1	3884
2	1924
3 – 4	1098
5 – 6	367
7 – 9	198
10 – 24	233
25 – 49	75
50 – 99	40
100 +	17

Source: TRNC Prime Ministry, SPO, General Industry and Firms Census 1998

Table 2.4 shows that the firms of TRNC are small sized family owned firms<sup>62</sup>. Therefore the firms of TRNC cannot realize economies of scale. Most of the firms do not have neither enough funds nor professional team for marketing, research and development.

The smallness of the TRNC market limits the number of the firms in the sectors hence lack of competition. The big firms, which have larger share in the market, are acting like monopoly. Table 2.5 gives more examples of sub sectors of TRNC, which have limited number of firms.<sup>63</sup>

**Table 2.5 The Number of Firms in Some Sub sectors of TRNC (Year 1998)**

Sub sectors	Number of Firms
Leather Products	17
Paper Products	10
Medical Instruments	2
Sea Transportation	3
Insurance	3

Source: TRNC Prime Ministry, SPO, General Industry and Firms Census 1998,

<sup>62</sup> TRNC Prime Ministry, SPO, General Industry and Firms Census 1998, Lefkoş, State Printing House, p: 4

<sup>63</sup> Ibid., pp: 9-10



## 2.2 Economic Development

Economic development is the aim of all countries in the world. The developing countries are competing with each other to increase the level of their development and to find a place among the developed countries. The developed countries are also trying to increase the level of their development. The aim of the economic development is to increase the wealth and the welfare of the individuals in the country.

The developments in technology are shaping the world economy. The quick developments in information, communication, and transportation technology, gave way to the globalization. The borders of the countries became more transparent in today's global world. The barriers against the free movement of the products and the factors of production are removing continuously. Therefore, the developing countries of today's global world have to arrange their development strategies according to the new order of the world economy.<sup>64</sup>

### 2.2.1 Economic Growth and Development

The phrases 'Economic Growth' and 'Economic Development' are used in terms of each others. The usage is generally acceptable but the meanings are not the same. In particular economic growth means more output, increase in GDP or increase in per capita income. Economic development implies not only increased output but also increased range of products, as well as changes in technical and industrial arrangements by which output is produced and distributed. Growth may involve, greater inputs leading to greater outputs. Development goes beyond this to include changes in composition of output and in the relative sizes of the contributions of the various inputs to the productive process.<sup>65</sup>

Economic development has a greater scope. In addition to being concerned with the efficient allocation of existing idle productive resources and with their sustained growth over time. Economic development also deals with the economic, social political and institutional mechanism, both public and private, necessary to bring about rapid and

<sup>64</sup> Philip Kotler, Sonkid Jatusripitak, Suvit Maesincee, *Ulusların Pazarlanması*, Türkiye İş bankası Kültür yayınları, Şefik Matbaası, Kasım 2000, s: 7-17

<sup>65</sup> Bruce Herrick, Charles P. Kindleberger, *Economic Development*, Singapore, Mc Graw-Hill Book Co. 1983, pp: 21-22

large-scale improvements in level of living of people. For economic development major structural changes have to take place in the society and in the economy. Therefore, development must be concerned with the economic, cultural, and political requirements for effecting rapid structural and institutional transformations for entire societies, in a manner that will most efficiently bring the fruits of economic progress to the broadest segments of their population.

### 2.2.2 The Goals of Development

Development means the conditions of realization of the human personality. Development takes into account three linked economic criteria; there must be a reduction in:

- i- Poverty
- ii- Unemployment
- iii- Inequality<sup>66</sup>

Some countries have experienced not only rapid growth of per capita income, but also increase in poverty, unemployment, and inequality. For example, the per capita income of TRNC increased from 1444\$ to 4978\$ between the years 1977 – 2000 (Table 1.1) but meanwhile unemployment and migration from TRNC are also increased. Table 2.6 shows the unemployment in TRNC.<sup>67</sup> The table is not realistic because the figures show only the registered unemployed people to the social security system. There is not any statistic about the unemployed persons who do not able to find a job in TRNC. The number of applicant for any vacancy in TRNC shows that the real figures of unemployment are seriously higher than the figures below.

Besides increasing in the GDP per capita, increasing in the quality is also important. The increase in quality means, the better health conditions, the better education, the better environment, the increase in justice, and the increase in social security. Table 2.7 gives statistical informations about the treatments in state hospitals<sup>68</sup>

<sup>66</sup> Dr. Erdal Guryay, **Economic Development**, Econ 516 Lecture notes, 2001, pp: 1-14

<sup>67</sup> TRNC Prime Ministry, SPO, **Economic and Social Indicators 2000**, p:3

<sup>68</sup> TRNC Prime Ministry, **Statistical Yearbook 2000**, p:71



**Table 2.6 Unemployment in TRNC in Between the Years 1994 – 2000**

Year	Number of Unemployed	Unemployment Rate
1994	704	0.92%
1995	752	0.98
1996	746	1.16
1997	754	0.90
1998	836	0.98
1999	957	1.08
2000	1416	1.56

Source: TRNC Prime Ministry, SPO, Economic and Social Indicators 2000

**Table 2.7 Treatments Provided by State Hospitals of TRNC Between 1994 – 1999**

Year	Number of Treatments
1994	208479
1995	186275
1996	195962
1997	233721
1998	261125
1999	171695

Source: TRNC Prime Ministry, SPO, Statistical Yearbook 2000

**Table: 2.8 Criminal Appeals Filed and Finalized in TRNC Between 1994 - 1999**

Year	Criminal Appeals Filed	Criminal Appeal Finalized
1995	18706	20297
1996	16058	15869
1997	17402	17167
1998	20382	19162
1999	22264	22166
2000	23734	23355

Source: TRNC Prime Ministry, SPO, Statistical Yearbook 2000

Table 2.8 gives statistical information about the load of the courts in TRNC and hence about the justice in TRNC.<sup>69</sup>

### 2.2.3 Development Strategies

There is not any unique program to increase the prosperity and the richness of any country in the world. If the developed countries of Europe, the USA, and the Newly Industrialized Countries (NIC's) of the Far East are examined, it can be seen that, the economic growth takes different forms. Therefore the method of economic development depends on the starting point of the country, the opportunities and the threats and at the same time the patterns of economic growth and the selection of high potential patterns of structural changes.

Every country has to get some strategic advantage in economic development compared to the other countries. According to Philip Kotler this is similar with the 'Strategic Marketing' of a firm.<sup>70</sup> It is much more complicated to govern a nation than a firm. It has social, cultural and political tasks which are not included to the strategic marketing of a firm. Development strategy does not mean governing any country with economic plans. Development strategy is a dynamic process, which controls and corrects itself.

First of all, the place of the country in the global world has to be well studied and well defined. The directions of the dynamics of the country have to be well known. That is, the question 'Where the country is going?' has to be examined. The direction and the aims of the development strategy of the country have to be well defined. Then, there must be some development plan and dynamic mechanism to correct and continue the process to reach the aims of development.

The factors of economic development are not purely economic. Cultural, political, social factors also play important role in economic development. Besides the daily work, the political leaders must have a vision and must design a mission to find out political solutions for economic development. The point of view implies, national

<sup>69</sup> Ibid., p:97

<sup>70</sup> Kotler, *op.cit.*, p: 9



development targets and national development plans and the way of applying national development plans. This can be defined 'National Development Policy'.

The national development policy must be related with the facts of local and global markets. Every nation has to resist against the global competition which presses local industries, which increases unemployment and which decreases the wealth of the nation. On the other hand, all the developing nations, has to develop and increase the prosperity of their people under this global competition.

TRNC applied five years development programs, and sometimes annual transition programs. On the other hand, TRNC did not have any development strategy, which considers dynamics of global world and the internal dynamics of TRNC. Because of the lack of the development strategy, the development of TRNC is not satisfactory. This can be seen from the retrospective analysis of TRNC economy in Chapter I.

#### **2.2.4 Problems of Developing Countries**

The main problem of developing countries is the living standards of their people. The poverty is a big problem. Also the income distribution is very important. The income gap between the high and low-income groups need to be decreased. Table 2.9 shows the per capita electric energy consumption, the per capita oil products consumption, automobile per 1000 persons as indicators of the living standards of the people in TRNC.<sup>71</sup>

Another important problem of developing countries is the high rate of increase of the population. Rapid population growth means more mouths to be fed and less food available per person. Rapid population growth also reduces the ability to save. Rapid increase in population creates serious problems in terms of food supply, public education, health and social services, and increases the unemployment. TRNC does not have high increase rate of population. According to the 1996 population census the population of TRNC was 200587 and the annual rate of increase of the population was 1.7%.<sup>72</sup>

<sup>71</sup> TRNC Prime Ministry, SPO, *Economic and Social Indicators 2000*, p. 3

<sup>72</sup> TRNC Prime Ministry, SPO, *Census of Population Social December 15 1996*, p: 6

**Table 2.9 Indicators of Living Standards of the People in TRNC**

Year	Per Capita Electric Consumption (kWh)	Per Capita Oil Product Consumption (Lt)	Automobile Per 1000 Persons	Telephones Per 1000 Persons
1994	2372	662	288	334
1995	2400	689	312	377
1996	2480	693	327	391
1997	2339	700	336	381
1998	2506	786	360	407
1999	2593	872	384	411
2000	2918	784	402	416

Source: TRNC Prime Ministry, SPO, Economic and Social Indicators 2000.

The other main problem of developing countries is unemployment. There is not enough physical capital for investment. The economic growth is not enough for the employment. Therefore today's developing countries have to develop under the unemployment. As it is explained in section 2.2 and shown in the Table 2.6 there is not reliable statistics about the unemployment in TRNC. The number of applicants to any vacancy in TRNC and the migrations from TRNC implies that TRNC has a serious unemployment problem.

Productivity is another problem, both the labor productivity and also technical productivity has to be understood from productivity. The products produced must be compatible in the global world. The over employment in the civil services implies low productivity in civil services which affects labor productivity of TRNC.

The developing countries suffer from lack of capital investment. These countries have problems of saving that are fewer margins for saving and investment. Another saving problem of the developing countries is that the high-income groups invest and deposit their moneys in developed overseas countries. As a result of lack of capital, the developing countries needs Foreign Direct Investments (FDI). Therefore the developing countries have to prepare investment opportunities for external investors. Table 2.10



shows the bank deposits and investments of TRNC.<sup>73</sup> As it is seen from the Table 2.10, there is not any saving problem of TRNC, but the problem is the savings do not turn to investments.

**Table 2.10 Deposits and Investments in TRNC**

Year	TL Deposits (Million TL)	Foreign Exchange Reserves (000 USD)	Total Investments (000 USD)
1994	5,483,804.7	348,884.3	79,841.94
1995	9,846,757.4	417,844.8	103,678.21
1996	18,769,500.5	513,821.3	120,509.81
1997	41,818,380.0	510,013.8	155,766.60
1998	73,750,886.9	622,337.0	173,399.31
1999	172,476,892.0	654,383.4	187,525.04
2000	292,771,506.0	631,878.0	179,554.54

Source: TRNC Prime Ministry, SPO, Economic and Social Indicators 2000

The quality and the adequacy of the infrastructure of a country play an important role in the economic development. Direct investments on the infrastructures of TRNC have been made by Turkey. Several projects for improving the quality of the infrastructures of TRNC has been applied and financed directly from Turkey. TRNC do not have any infrastructure problems, which prevents the development.

## **2.2.5 The Fundamental Factors Which Effect Today's Developing Countries**

### **a-) The Global Dependence**

After the Second World War, there is an increasing trend in globalization. Today's global economy connects all the different parts of the world and makes them dependent to each other. Which is called the global dependence.<sup>74</sup> Under the global dependence, the worst development strategy target for any developing country is to become self-sufficient. In today's world it's not possible for any country to produce all needs. Therefore every country has to produce the compatible products, which have

<sup>73</sup> TRNC Prime Ministry, SPO, Economic and Social Indicators 2000, pp: 20,21,46,47

<sup>74</sup> Michell A. Seligson, John T Paseé-Smith, Development and Underdevelopment, Colorado, Lynne Reiner Publishers, 1998, pp: 254-257

competition power in global world market. On the other hand they have to import those, which are not compatible.

### **b-) Protectionism and Economic Blocks**

Globalization of the world means lowering of the barriers of free movements of the goods, the services and the factors of production. Taking into account the global dependence, it is not possible in today's world to increase the barriers to external products and apply import substitution to increase the domestic production. Therefore the developing countries have to adopt some development strategy to process in the global market. On the other hand, the number of economic blocks is increasing continuously. The economic blocs increases the volume of inferior trade, decreases the production costs. The biggest economic block of the world is the European Union (EU).

The developed countries and the economic blocks protect mainly their agricultural products and agricultural industries. A good example is the Common Agricultural Policy (CAP) of the EU. As a result of CAP, the EU has huge agricultural products stocks. CAP puts high barriers against the imported agricultural products. On the other hand, the main exports items of developing countries are agricultural products. Therefore it's not easy for those developing countries to compete with the high technology and highly subsidized agricultural products of developed countries and of the economic blocks.

### **c-) The Effects of Multinational Companies**

The increased demand for FDI's of the developing countries, and the increased incentives given to the FDI's, increased investments in other countries. Taking into account the maximization of the comparative advantages of the companies, the number and the sizes of the multinational companies in the world increased.<sup>75</sup> The balance sheet amount of many multinational companies are greater then the budgets of many developing countries. The power of multinational companies has to be accepted. On the other hand, by the mergers of multinational companies and by the concentration of multinational companies to the specific sectors, the market shares of the multinational companies in the world getting larger and larger. The multinational companies are the

<sup>75</sup> Kotler, *op.cit.*, pp: 25-27



fact of the today's global economy. The developing countries have to consider the effects of multinational companies to their development strategies.

#### **d-) Rapid Technologic Developments**

The rapid developments in the information and telecommunication technology, simplified to reach the information and to use the information. New technologies developed in many industries. These new technologies increased efficiency and decreased the costs. On the other hand, the share of labor in the produced output, and amount of consumption of input materials are decreased as a result of the new technologies. Many multinational companies, started to transfer the operations, which need more, labor from developing countries to the industrialized countries and consume new high technology. The importance of the cheap labor endowment of a foreign country in the decision for FDI is decreasing. On the other hand the importance of the level of technology of the foreign country and the cost of market access is increasing.<sup>76</sup>

The developing countries have not only to make structural changes for industrialization, but also have to adopt new high technologies to their production. Also they have to increase the quality of their infrastructure. It is a big risk for the developing countries, which based their development strategies and their exports on cheap labor endowment of some material resources.

#### **2.2.6 The Political Dilemmas in Economic Development.**

One of the political dilemmas in the developing countries is the imbalance between growth and income distribution. Economic growth needs capital concentration and supports to investors, which disturbs the income distribution and increases the gap between low income and high-income groups. On the other hand, the savings of the high income groups of the developing countries do not go directly to local investments but are transferred to 'Safe developed countries'.<sup>77</sup>

Another important dilemma is the government interventions to the market and supports to local production. In order to increase and develop the local production,

<sup>76</sup> Michael E. Porter, *Rekabet Stratejisi*, İstanbul, Kurtiş Matbaacılık, 2000, pp: 364-369

<sup>77</sup> Kotler, *op.cit.*, pp: 43-58

sometimes it is necessary to put some restrictions to the goods market. On the other hand, big supports to local production and input substitution policies, in the long run, results old technology consumption and high input costs. Which means wasting of economic resources of the developing countries. The basic target of government interventions has to be to accumulate economic development. Therefore, the main policy for government interruptions has to be, macroeconomic stability, stable and reliable financial market, stable prices in goods and labor markets, high quality human resources, and new technology consumption.

Government interventions have to be dynamic and changeable, depending external and internal conditions, to help the export-led growth and to use strategic finance. The aim of the government interventions and subsidies should never be to obtain political advantages. If instead of economic logic, politic logic is used in the application of the subsidies and interventions, the political corruption starts. In other words, instead of the economic aims if the aims of subsidies and interventions become to increase the votes of the governing party in the next election then the corruption starts to take place. Under the circumstances of corruption, sustainable economic development is not possible. The followings are very important in avoiding the corruption.

- i- The ideology of the elites has to be parallel with the economic development. The groups of the society have to aim the development and not to fight to obtain unearned incomes for the members of their groups.
- ii- The welfare of the economic development has to be distributed as equal as possible in the society.
- iii- The bureaucrats and the economic technocrats have to be isolated from the pressure of the politicians.<sup>78</sup>

In TRNC there are many groups and associations who are fighting for obtain better economic and social advantages to their members. The bureaucrats and the economic technocrats have rigid dependence with the political parties. Therefore the high level bureaucrats and economic technocrats are changing frequently depending on

<sup>78</sup> Godfrey Baldachino and Robert Greenwood, *Competing Strategies of Socio-Economic Development for Small Islands*, Charlottetown, University of Prince Edward Island, 1998, pp: 31-35



the changes of the governments. Also the changed bureaucrats become idle and get payment, which is the waste of resources both economic resources and high skilled human resources. The dependence of the bureaucrats and technocrats to the political parties affects their administrative decisions. Instead of the merit based progress, the choices of governing political party comes first, in the progress of the civil servants.

### 2.2.7 Comparative Advantages of The Countries

The countries of today's global world are becoming dependent to each other's. This pushes them to take into consideration the comparative advantages of the countries. There are too many buyers and too many sellers and many kinds of economic resource endowments in today's global world. Therefore the developing countries have to create different trading strategies.

The developing countries have to determine their strategic powers and weaknesses in the international competition. According to Micheal E. Porter<sup>79</sup> in order to increase the national wealth of any country, it has to improve its comparative advantages.

The developing countries at the beginning of the development, starts to improve the productivity of their economic factors. Second step is while encouraging the savings to increase the advantages of the investing new technologies and bringing new Foreign Direct Investments (FDI). Then the developing countries have to change their technologies from high labor technologies towards capital content high technologies.

The industrialized countries put pressure on the developing countries with new high technologies. On the other hand; at the industrial segments where price competition is important, the Newly Industrialized Countries (NIC's) put pressure on the industries of the developing countries. This is shown in Fig 2.1.<sup>80</sup>

<sup>79</sup> Michael E. Porter, *The Comparative Advantages of Nations*, New York, 1990 pp: 5-17

<sup>80</sup> Kotler, *op.cit.*, pp: 105-106

### Region A

The countries, which has high technology in the simple product markets. The NIC's are getting the power in the market.

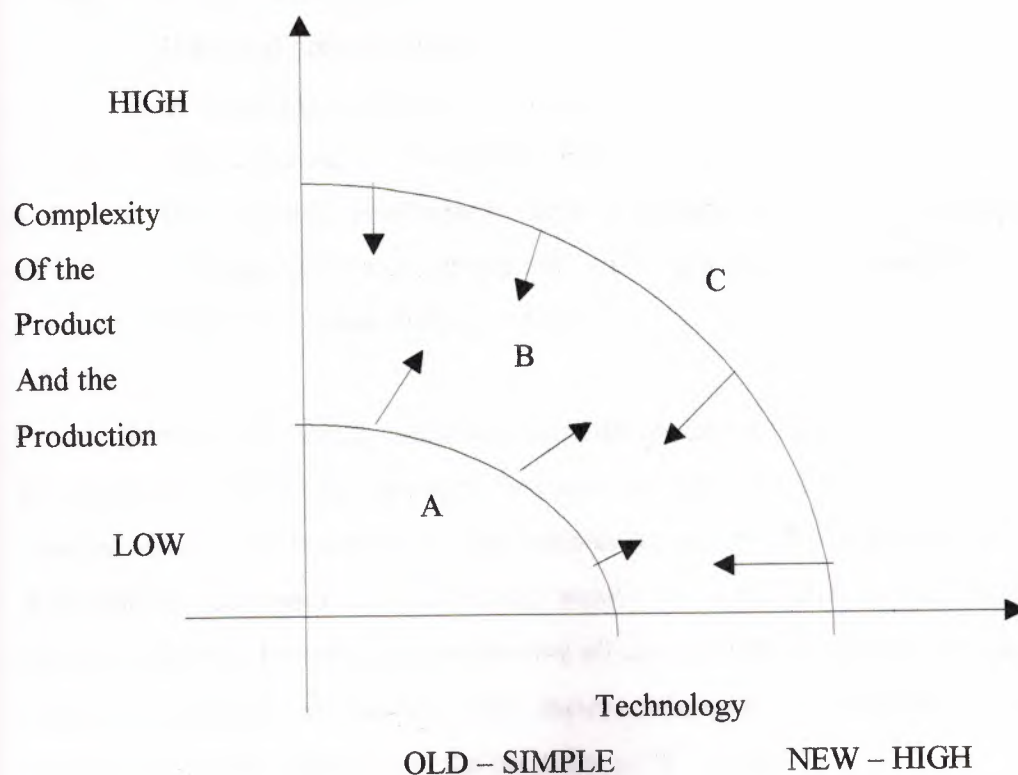
### Region C

Highly complex and new technology dependent markets. The industrialized superpowers are increasing their powers in the market.

### Region B

By adopting new technologies to the traditional products region C is enlarging. By starting the production of the complex high technology products NIC's enlarges the region A. Taking into consideration of their factor endowments, and of their strategic positions, the small developing countries are in the region B and are pressed from both sides namely regions A and B.

**Figure 2.1 Pressures on the Developing Countries**



Developing countries have to find some niches for themselves in the international competition. Also the developing countries have to determine their



position very accurately in the international competition.<sup>81</sup> They have to know their strategic position in the global market with respect to other countries and make strategic joint ventures with each other

Developing countries have to find their place very accurately in these strategic groups in this global competition. The strength and weaknesses of the developing countries, the competing and helping countries, the opportunities and the threats in the strategic groups and between other strategic groups have to be determined very accurately. In order to increase their national wealth in the today's global and changeable world, the developing countries have to direct their economic capacity towards the markets in which they can compete. The economic capacity of the countries depends on five components:<sup>82</sup>

- i- Culture, behavior and mentality of the people,
- ii- Social dependence,
- iii- Factors endowment,
- iv- Industrial organizations (The barriers on free competition and trade, the level of education, information and transportation structure, subsidies and credits)
- v- The leadership of the government (The politicians, who are making decision for economic development, have to consider not only the economic capacity but also the levels and the interaction and change of components. This is a dynamic decision making process)

In many developing countries, because of the parliamentarians do not consider the public benefit first but consider their own benefits, the power of the government is reduced. Hence the bribery and degeneration increased. The high level of bribery and degeneration decreases the economic wealth of some developing countries. The degeneration puts barrier to the productive allocation of the resources. The degeneration does not consume only the economic factors of developing country, but also causes erosion on culture, behavior and the mentality of the people.<sup>83</sup>

<sup>81</sup> *Ibid.*, p. 111

<sup>82</sup> *Ibid.*, p.138

<sup>83</sup> Seligson, *op.cit.*, pp: 195-197

The correct allocation of the resources is a very important factor in increasing national wealth. Sometimes important factors are highly allocated to some industrial sectors, while the other sectors have lack of that factor. This decreases comparative advantages of the developing countries.

Political instabilities also decrease the comparative advantages of the developing countries. Political instability courses movement of national capital away from the country and puts barrier to FDI's.

The income gap between rich and poor countries has grown dramatically after the Second World War. Therefore, today's developing countries has to increase their national wealth quicker then the rich countries to close the gap. The governments of the developing countries have to apply the best development strategy to catch the rapid and sustainable economic development.<sup>84</sup>

### 2.2.8 Conclusion

In the first section of this chapter the common economic problems of small island economies is studied. A brief analysis of most important vulnerabilities of Small Island Developing States (SIDS) is made. The practical effects on the TRNC economy of these problems and vulnerabilities are discussed.

In the second section, economic development is discussed. The aim of the economic development is to increase the wealth and welfare of the individuals in the country. The problems of the developing countries in today's global order of the world economy are studied. Also the effect of globalization to the developing countries is discussed. Then, the political dilemmas and the effects of political decisions on economic development of the developing countries are studied.

Every developing country has to adopt its own development strategy. This strategy has to consider and to be harmonized with the global economic order of today's world. Also the strategy has to consider the external and internal comparative

<sup>84</sup> Douglas G. Lockhart, David Drakakis – Smith and John Schembri, *The Development Process in Small Island States*, London, Routledge, 1993, pp: 39-45



advantages and external constraints and internal weaknesses. On the other hand the developing countries have to develop (have to increase their wealth) quicker than the developed countries in order to decrease the income gap in between. Next chapter is devoted to the experiments of some newly developed countries.





### 3.1 Development Experiments of Some Countries

In the second half of the twentieth century some countries increased their national wealth rapidly. In this chapter the experiments of some of these countries is discussed. The experiments of Newly Industrialized Far East Countries, Cyprus and Ireland are considered.

After 1960 some countries of Eastern Asia are developed rapidly. These countries are called NICs. The Far East experiment showed the economists that, the development of less developed countries in the capitalist system of the world is possible. All the countries of Far East were old colonies, and after establishing their own governments they developed very rapidly. Economists call these Newly Industrialized Far East Countries as Asian Tigers. These countries are South Korea, Taiwan, Singapore, Hong Kong, and Malaysia. These countries proved that it is possible to make capital concentration and economic growth with other than American and European culture.<sup>85</sup>

The external factors played a positive role in the development of the east countries. The main external factor was the increase in demand of America and Europe to the imported goods. The second external factor was, in those years the developed countries transferred their high labor content industries to the cheap labor countries. These factors were the same for other parts of the world but they did not developed like the NICs.

After the establishment of their own governments the Asian Tigers got foreign aids from USA according to the Marshall Plan of USA. The application of the Marshall Plan after the Second World War aimed to surround the Soviet Block with the countries, which have good relations with USA. In those years many countries received this kind of foreign aids but only Asian Tigers managed to develop quickly. Therefore it is not possible to explain the development of Asian Tigers purely with external factors.

Many Social scientists and economists emphasize the cultural foundation of the Far East. It is important to work hard and to be honest, dependence to the company and

<sup>85</sup> Atilla Sönmez, **Doğu Asya Mucizesi ve Bunalımı**, İstanbul, Bilgi Üniversitesi Yayınevi, 2001, s:25-45

the family structure, for increasing the production. There must be something more than cultural foundation for economic development and this is development strategies and economic policies.

Although there are common parts of the applied economic policies of the NICs the main policies are different. For example South Korea didn't have Foreign Direct Investments (FDI) while the development of Singapore and Malaysia are based on FDIs. Japan and Korea based their capital concentration on big companies while Hong Kong and Taiwan did opposite.

The common parts of the economic policies of Asian tigers are concentrated government interventions and effective management of dynamic comparative advantages of the country. Fig 3.1 shows the main factors which resulted the development of Asian Tigers.<sup>86</sup>

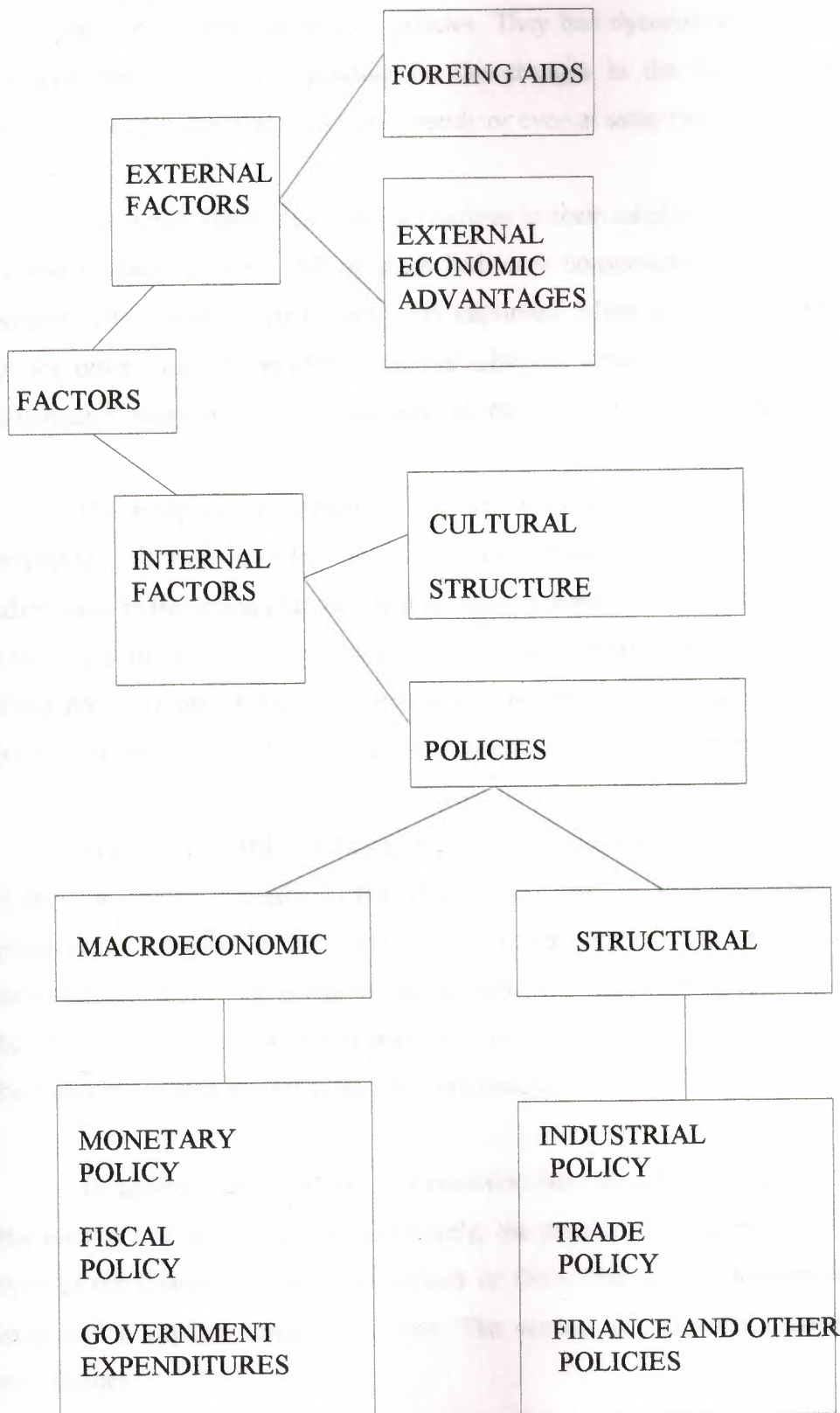
All the NICs of Far East used nearly the same strategy for economic development. At the beginning of the development period all Asian Tigers experimented import substitution for a short period. In order to obtain comparative power in international market, they began with high labor-intensive industries. They increased their experience both in the production and export markets. When the wages started to increase and they lost their cheap-labor advantage they passed to capital-concentrated sectors and started to use new technologies. First they borrowed new technologies from the developed countries then they invested research and development. Now they are at the edge of the new technology and they are developing their own technology and competing with other developed countries.

There are two different schools about the role of the government in the economy. According to the neoclassic economists the role of government have to be limited by education, preparation of legal and technical infrastructures, and stabilization of the economy. They do not accept the government interventions to the goods market for determination of the prices. On the other hand, other economists accept the

<sup>86</sup> Dr. Murat Yülek, *Asya Kaplanları ve Sanayi Politikaları*, İstanbul, Alfa Basım Yayım Dağıtım, 1998, s: 6



government interventions by taxes by subsidies or by limitations and by other tools of the market to affect the market prices.<sup>87</sup>



**Fig.3.1 The Main Factors Which Resulted The Development of Asian Tigers**

<sup>87</sup> Kotler, *op.cit.*, pp: 59-65

The economic policies of governments can be defined as in two categories namely macroeconomic policies and structural policies. The Asian Tigers depended some predefined strategies in both policies. They had dynamic strategies. That is they changed their strategies depending on the changes in the market. Sometimes they applied two opposite strategies subsequently or even at same time.

The Asian Tigers had some similarities in their macroeconomic policies namely, monetary, fiscal policies. All of them had very conservative budgets and monetary policies. The balance of budget was very important. Many of them had budget excesses. On the other hand, the incentives and the subsidies of the industrial sectors had priority in budget. Government investments were as important as monetary and fiscal policies.

The body of the structural policies was the industrial policy. The logic of industrial policy is to select the industries, which have or will have comparative advantages in the world market. Then to support these industries enjoys the comparative advantages to increase their share in the world market. Supporting the industry has some costs to the society. According to the strategies of Asian Tigers, the future benefits of the industry must be greater than the costs of the supports.<sup>88</sup>

The concentrated and clever interventions of the governments can be seen in all Asian Tigers but especially in the South Korea and Taiwan. They had some special performance criteria for the companies in order to enjoy the excess benefits of the interventions. They had penalties for the failure of the companies. The openness and being competitive in the export markets were very important performance criteria for the subsidies. These criteria measured very carefully.

In general the government intervention has two main problems. Assuming that the intervention will be applied effectively, the problem is whether the selection of the type of the intervention policy is correct or false. The second problem is whether the intervention applied effectively or not. The success of intervention depends on these two factors.

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<sup>88</sup> Robert Wade, **Governing The Market**, New Jersey, Princeton University Press, 1990, pp: 8-12



In the success of Asian Tigers, besides the clever applications of economic policies, the hard work of the people played important role. The high performance of the Far East countries depends not only the increase in quantity and quality of the factors of production but also increase in efficiency.<sup>89</sup>

### 3.2 The South Korea Experiment

Between the years 1950 – 1960 South Korea was one of the less developed and one of the poorest country in the world. The main characteristic of South Korea, which differed from the other less developed countries, was, the relatively high education level of the people. After the year 1990 Korea was among the first most developed countries.<sup>90</sup>

The per capita GNP in dollars with constant prices increased sixteen times between the years 1962 – 1991. The structure of production changed in the same period. The share of agriculture in GDP was 35% in the year 1961 and it decreased to 8% in the year 1991. On the other hand, the share of industry increased from 16% to 28% in the same period. The industrial exports increased from 16% to 62% in the same period.<sup>91</sup>

The economic development of Korea can be analyzed in three main periods. The common properties of all three periods are, the massive government intervention and control of the markets, changing the structure of the production to catch the dynamic comparative advantages in the world market, export led growth and therefore, production according to the worldwide standards to the world market.

In the first period of the development Korea started with import substitution. They applied defensive and in the same time export incentive industrial policies. In the second period, there were massive interventions of the government to the allocation of resources. At the end of this short period Korea was an industrialized country. In the third period, after the year 1980, instead of giving incentives to the individual sectors, they started to give massive intensives to the technology and research and development.

<sup>89</sup> Kottler, *op.cit.*, pp: 60-70

<sup>90</sup> K. Kim, D.M. Leibziger, *Korea: A Case of Government Led Development*, Washington, World Bank, 1993, p: 3

<sup>91</sup> *Ibid.*, p: 4

The prevention of industry and encouragement of export were complement of each other. According to the industrialization policy the manufactured goods, which has export capacity, had some barriers in order not to sell big capacities direct to the domestic market, and have some incentives to the direct sales to the world market.

The government declared to the entrepreneur and to the public the importance of export performance and how the export will be granted. The physical infrastructure of South Korea has been built up by public sector for the industry.

After the year 1973, they changed import substitution and export incentive industrialization policy. They applied sectoral development strategies. After changing their industrialization policy, exports increased more quickly. Therefore according some economists, the main reason of Korean economic development was not the intensives of exports but encouragement of investments.

Instead of arranging a system to prevent the current comparative advantages, the decision makers in Korea applied a dynamic model to reach the targeted external trade system. The Korean development model based on to reach the world market and to increase the power of Korean manufactured goods in the export markets.<sup>92</sup>

The industries, which had government incentives, the economies of scale, efficiency and comparative product prices were essential. The small capacity of the domestic market like Korea, yielded increase in importance of exports in these industries. This increased the importance of scale economies. Therefore the investment projects had to be arranged so that the price of unit manufactured output must have a competitive advantage in export market. The success of the program was measured by reaching the competition power in the world market, in the targeted period and by the export performance. Effective and detailed planning applied in order to reach the targets.

<sup>92</sup> Jene K. Kwon, **Korean Economic Development**, New York, Greenwood Press, 1990, pp: 3-17



The trade policy of Korea based on the promotion of exports to shift the trade towards exports. South Korean government actively promoted manufactured exports, using trade policy. Considerable protection given to the manufacturers who met export targets set by the government. A policy, setting targets for the exports made particularly good sense, meaning that the average costs of production decline with the volume of output.

Thus from 1960's the South Korean government induced domestic companies to link production for protected domestic market (import substituting industrialization) with production for exports (export oriented industrialization). In general, manufacturing profitability was high in South Korea but only because losses on exports were more than compensated for high profits on domestic sales.

Government policy on exchange rates generally supported the export. The encouragement offered by falling exchange rate was additional to that provided by direct and indirect subsidies already given through the tariff protection structure and export targeting arrangements. In general the trade policy played major path in South Korea's export success. The government directed the banking sector to provide long-term loans to the industry at preferentially low interest rates. Although the interest rates paid to depositors were high in real terms, the interest rates were not necessarily high to approved borrowers, such as companies for export. In other words the approved industrialists had credits with relatively low interest rates with longer terms. The Korean government had considerable interventions to the areas of trade, finance and industrial diversification to build up an industry with high power in the world market.<sup>93</sup>

The government had actively directed the growth in manufacturing sector through its trade policy and through other policy measures. The industrial growth was spread across most industries. In early 1970 South Korean government took additional steps to develop heavy industries. That is the industrialization strategy changed away from labor-intensive industries towards more capital-intensive industries.

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<sup>93</sup> *Ibid.*, pp: 53-60

Borrowing technology is importing foreign technologies, adopting these technologies to the local conditions and developing new technologies from the imported technologies by improving them. Borrowing technologies does not mean technological dependence. South Korea borrowed technology and generated new technologies domestically based on the borrowed technology. The successful absorption by South Korea of foreign technology has to large extent been due to the interventionist role of the state in the acquisition and development of the technology.

It is correct to say that South Korea has been a huge sweatshop. Average hours of work have been at least 54 hours a week for people employed in manufacturing. The wages rose rapidly between the years 1960s and 1970s. In average monthly wage of a factory worker were 50 USD and 70 USD in the year 1969. The male – female wage gap was greater in South Korea than in any country for which data were available from the International Labor Office<sup>94</sup>

The real wages started to rise from 1970, but the low wage has combined rising labor productivity to maintain the competitiveness of South Korean manufacturing sector. The Korean governments kept low the prices of agricultural products. Lower agricultural prices meant that excess labor ready to migrate from rural agricultural areas towards urban industries. Lower wages and incomes in agriculture favored the maintenance of low wage levels in industry.

### 3.2.1. Chaebols

The Korean governments also intervened in the area of ownership. Chaebols are the family owned group of companies the activities of which are controlled by the government. Manufacturing industries are dominated by chaebols.

Government – Chaebol cooperation was essential to subsequent economic growth and successes of South Korean economy. Political leaders and government planners relied on the ideas and cooperation of the chaebol leaders. The government provided the blueprints for industrial expansion, the chaebol realized the plans.

<sup>94</sup> Tom Hewit, Hazel Johnson, Dave Wield, *Industrialization and Development*, London, Oxford University Press, 1992, pp: 117-118



However the chaebol-led industrialization accelerated the monopolistic concentration of capital and economically profitable activities in hands of limited number of conglomerates.

The government used chaebol as a means towards economic growth. Exports were encouraged. Performance quotas were established. The chaebols were able to grow because of two factors – foreign loans and special favors. Access to foreign technology also very critical to the growth of the chaebols. The government selected chaebols to undertake projects and channeled funds to them, from foreign loans. The government guaranteed repayment should a chaebol be unable to repay its foreign creditors. Additional loans were available from domestic banks.

The chaebols were family oriented, but the major business of the chaebol remained under control of government. Individual chaebols were prevented from buying controlling shares of banks. After 1990 government regulations made it difficult for chaebol to develop an exclusive banking relationships, hence the access of the chaebols to credits were controlled by government.<sup>95</sup>

The tremendous growth that the chaebol experienced was closely tied to the expansion of South Korean exports. Another reason for the success of the chaebol was their access to foreign technology. (For example, Hyundai Cars used an engine developed by Mitsubishi – Japan).

The chaebols were powerful independent entities acting in the economy and cooperated with the government in the areas of planning and innovation among the certain areas and avoid total monopolies.

Chaebol first arose in South Korea in 1920 and 1930 when the country was under the Japanese colonial rule. Japan planned Korean's economic development to feed its own markets and set up a series of companies which were privately owned and run but strictly controlled by the central government, through credits, through the approval or not the trading licenses, and host of other measures. Japanese had same type

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<sup>95</sup> Kwan, *op.cit.*, pp:332-337

of companies in Japan, named Kerietsu. Koreans developed the Japanese system for themselves after they had managed to win their independence. The major difference between Korean chaebol and Japanese kerietsu is; kerietsu centered on one large financial institution or bank while chaebol do not have their own financial institutions. Also chaebols are much more family oriented based than kerietsu.

The capital concentration and rapid industrialization of Korea based on the successful co-operations of government and chaebol and clever interventions of the government to goods market, finance market and labor market. After 1980 government reduced the number of goods under import restriction, which was a sign of economic liberalization. Alongside this, government continued to direct the restructuring of industry and investment.

### 3.3. The Taiwan Experiment

After being a Japanese colony for 50 years, Taiwan obtained freedom in the year 1945. The infrastructures and the few factories, which Taiwan got, were destroyed during the war. In those years Taiwan was a very poor country, the only production was rice production, which exported to Japan.

In the year 1949 the Kuomintang Government escaped from China together with 1.6 million people and settled in the island. This was the 25% of the population of Taiwan in those days.

At the beginning of 1950s Taiwan was a very poor island country, which had labor force excess and very limited economic resources. The only production was agricultural (rice) production. Today Taiwan is one of the leading exporters of the world.<sup>96</sup>

Taiwan had an agricultural reform between the years 1949 and 1953. As a result of this reform, the ratio of farmers who did not have their own field in the population, decreased from 36% to 15%. Together with the reform, Taiwan started to modernize the

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<sup>96</sup> Yülek, *op.cit.*, p: 91



agricultural production. The result of the reform and the modernization, the agricultural production increased 50% between 1953 and 1961.<sup>97</sup>

At the beginning of 1950s Taiwan had import substitution economic policy. For the development and coordination of manufacturing industry, Taiwan Production Board (TPB) established. The import tariffs were increased. The import quotas applied to the luxury consumer goods. Taiwan put barriers to imports of consumer goods while eliminating the barriers of investment goods. On the other hand, government concentrated to the supports on certain selected industrial production; such as fabric, cement, bicycles, and flour.

The imports of the investment goods increased while the imports of consumer goods decreased. As a result, the total imports did not decrease. During the period, Taiwan had serious payment problems. The second outcome of this defective policy was the industrial products of Taiwan, which produced for the domestic market had no competitive power in export markets.

In 1960 new economic and financial program applied and new promotion for investments and exports started. The exporters started to obtain low interest credits and tax refunds. The bureaucratic problems of investment removed and promotion to the domestic and foreign direct investments increased.

The Export Process Zones (EPZ) played very important role in the increase of exports of Taiwan. The aim of the EPZs was to use the labor force of Taiwan and the imported raw materials to produce industrial products and export. Both, foreign and domestic firms made investments in EPZs. The EPZs decreased the costs of the initial investments of the firms and offered them good infrastructure facilities. The FDI's are expected to bring new know how and technology and new export markets. Selling to domestic market from EPZs was not allowed.

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<sup>97</sup> K.T. Li, *The evaluation of Policy Baland Taiwan's Development Success*, New Heaven, Yale University Press, 1988, pp: 12-25

The outcome of a research held in 1967, showed that the soil of Taiwan was eight times more productive than the soil of USA, while the farmers of Taiwan were working eight times less efficient than the USA farmers. The main reason of this was the average farming area of Taiwan was too small for modern mechanical farming. On the other hand, the second generation of farmers, instead of working in the fields they were preferring to educate and work in the industry. Because of these reasons, Taiwan made the second agricultural reform (in the opposite direction of the first) and increased the amount of the field owned by the farmers.<sup>98</sup>

The pressure of the petrol crises and the increase in wages led Taiwan to capital concentrated new technologies. In 1970 Taiwan made important changes in the science and education policy. Taiwan aimed technologic concentration and production of new technologies. By the end of 1970 the Science Based Industrial Park (SBIP) established in Taipei. The aim of the Industrial Park is to make a dynamic coordination together with the University and research and development institutions.

Government promoted research and development. They made a new strong patent law. The Industrial Technology Research Institute (ITRI) established. The main function of ITRI was to research and development alone or together with the other firms on selected industries to increase the technologic concentration and to supply new technologies to the private investments.<sup>99</sup>

In 1978 Taiwan gave new direction to the science and technology policy. Taiwan selected main technologies (energy, materials, information technology, automation, optoelectronic, biotechnology) and planned to increase the quality and quantity of experts in these technologies, by opening new postgraduate education programs.

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<sup>98</sup> Yülek, *op.cit.*, pp: 92-97

<sup>99</sup> *Ibid.*, pp: 98-105



### 3.4. The Hong Kong Experiment

Hong Kong was a small entrepo city in 1950. In very short time Hong Kong had an industrial revolution and became a developed economy based on mainly service production. Today Hong Kong economy based on four main pillars namely, electronic production, tourism, finance and immobile development.<sup>100</sup>

Since Hong Kong is a city country the only alternative for development of Hong Kong was to open the city to the world markets. On the other hand, Hong Kong had to make exports in order to make imports. The main advantage of Hong Kong in the years 1950s was the human capital, which had experience in trading. Hong Kong used this capital very well. Hong Kong saw the gaps in the world market and used them. Hong Kong had excellent benefit from being the opening gate of China to the external world. Because of this reason, trade and tourism developed. After the 1970s the importance of finance sector increased.

The most scarce resource of Hong Kong is the lands, since it is a small city country. Therefore Hong Kong has a very live immobile market and government had concentrated intervention tools to the immobile market. The lands which government planned to develop were rented for a long period by tenders to the private firms.

Hong Kong government gave direct supports to exports and directed companies to the export markets by the trade policy. In 1966 Hong Kong Trade Development Council (HKTDC) established and opened branches in 33 countries. The aim of HKTDC was to increase the exports of Hong Kong. The HKTDC organized fairs and acted as a bridge between export markets and Hong Kong companies.

After 1970s the quick improvements in the finance market resulted a new and developed communication and information networks in Hong Kong. As a result of this development in Hong Kong many multinational companies selected Hong Kong as the operation base of Far East. This affected tourism positively.

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<sup>100</sup> *Ibid.* 106-113

As mentioned above, the government interventions in Hong Kong was limited with to regulate the market and build up the infrastructures and education, which are the basic functions of government. Except the immobile sector, there were concentrated government interventions.

Like the other tigers, Hong Kong had a very conservative budgetary policy. (Except seven years; the Hong Kong budget had excess in the years between 1946 – 1990). The budgetary policy linked with law taxation policy, offered funds to be use of the private sector.

The role of government in the technologic development of the industry was limited in Hong Kong. As a result of this, the trend of passing to the high technology industry was weak in Hong Kong, on the contrary of the other tigers. Hong Kong government established new technologic development policy in 1990s. According to this policy, government started to give free lands to the high technology companies, government started to establish industrial zones for high technology firms, and also productivity centers, science parks and technology improvement centers.<sup>101</sup>

Hong Kong is the opening gate of China to external world. After the 1978 reforms in China; the private sector and the market mechanism started to operate in the special zones. Hong Kong had maximum benefit from these changes in China. The firms of Hong Kong carried their production to these zones in China and increased their competitive power in the export markets. As a result of this Hong Kong became a designing, financing, quality controlling center of China. Hong Kong firms had an active role in the building of China. The Chinese companies quoted their shares to the Hong Kong stock market.<sup>102</sup>

<sup>101</sup> Sönmez, *op.cit.*, pp: 213-215

<sup>102</sup> Yülek, *op.cit.*, p: 109



### 3.5. The Singapore Experiment

Singapore Island was a Crown Colony of UK for a long period. In the years between 1942 and 1945 the island was a Japanese colony. Singapore was a member of Malaya Federation between 1945 and 1965. The federation with Malaysia ended in the year 1965. When Singapore had her own government the people had very low income, they had unemployment, poverty and health problems. Starting from this point, Singapore had per capita income of 26750 dollars.<sup>103</sup> Today Singapore is a high technology society and number one in the world in the information technology. Singapore Island is the center of high technology and finance at Far East.

Singapore had very clever, effective and flexible development strategies. On the contrary to Hong Kong, Singapore had concentrated interventions to the economy and supported certain selected sectors.

In the years of federation with Malaysia, Singapore applied import substitution policies. On the other hand, because of the huge unemployment problem, Singapore supported the high labor content industries. During this period, Singapore established the Economic Development Board (EDB) and started to coordinate all the economic development and industrialization activities. EDB started to give, consulting services to the entrepreneurs, finding credits or partners to the investments and establishing industrial zones.

The federation with Malaysia ended in the year 1965 and Singapore became a separate city country. After the end of the federation, since the domestic market of Singapore was very small, the import substitution policies became meaningless. But still the unemployment was very high. Therefore for the development of Singapore FDIs were essential. After the end of the federation, Singapore government increased promotions of industrial investments, especially for the FDIs.

EDB established new industrial zones and opened information centers in other countries and marketed Singapore to the foreign investors. The FDIs must not be for

<sup>103</sup> Asian Development Bank, *Key Indicators of Developing Asian and Pacific Countries*, Manila, Oxford University Press, 1994, pp: 272-275

only the domestic market of two million people but also for exports to the foreign markets. As a result of the increase in the FDIs the unemployment problem settled and the wages started to increase. After the year 1970 the Singapore government changed the promotions from the high labor content industries to the high capital content industries. The FDI policy of the government changed from low wages towards high skilled labor. Singapore started to change its economy towards computer industry, medical industry and consultancy. Singapore government put extra taxes to the industries, which consume low skill labor. The skills and the education levels of the workers increased with the application of special programs.<sup>104</sup>

The two pillars of the development strategy of Singapore in the recent years were to increase the skills and capacity of the human resources and to promote the FDIs.

### **3.6 Lessons From The Development Strategies of the Asian Tigers**

There were similarities and differences among the economic development models of South Korea, Taiwan, Hong Kong and Singapore. According to Prof John Page<sup>105</sup> the policy makers in the Far East, established clever development strategies, which had clever and effective relations among the firms, government, and business world. The policy makers arranged a well-designed economic competition area among the firms. The logic of the competition based on the well-established reward criteria. These performance criterias observed by the government and the other competitor firms. The performance rewards were not only the access of cheap credits, but also other complex benefits to the investors. The basic foundations of the Asian Tigers development strategies were the competition and performance measuring among the firms and the high quality civil services isolated from political interruptions.

The contribution of above two factors to the rapid growth of the Far East countries are important. The effective macro economic management stabilized the atmosphere of private investments. The basic human rights were provided and guaranteed by the legal systems. The selective government interventions applied very carefully.

<sup>104</sup> Yülek, *op.cit.*, 115-126

<sup>105</sup> John M. Page, *The East Asian Miracle, An Introduction*, World Development Report 1994, Volume 22, pp: 235-247



Every intervention to the market has a cost to society. Generally, the cost was controlled within the certain limits. The future benefits of the interventions were measured in order to be greater than the cost.

There were big differences in the structure and the application of the government interventions among the Asian Tigers. The economic development of South Korea and Taiwan based on local capital concentration with selective and effective government interventions. Hong Kong was a successful example for economic development with market economy. The economic development of Singapore based on the support of FDIs and high technology.<sup>106</sup>

At the beginning of their economic development, the two city countries Hong Kong and Singapore had nothing except their harbors. Besides these similarities, the external factors and the places of two countries were different. Therefore they used two different development strategies. The government interventions did not have any important role in the economic development of Hong Kong, but on the other hand, the economic development of Singapore based on the clever and effective government interventions.

The sectoral developments in Hong Kong, achieved with the market dynamics. As a result of this policy, the research and development investments of the companies of Hong Kong were considerably low. Therefore the Hong Kong industry didn't consume high technology. Because of Hong Kong is the opening gate of China to the external world; Hong Kong became a transit trade and finance center. Singapore government acted more selective and directed the industrial development. As a result of this strategy, Singapore became a producer of high technology, a sophisticated service provider and tourism and finance center.

The government decisions of the Asian Tigers were based on economic logic, while the government decisions of other developing countries based on political logic. There were three basic reasons because of which the governments of Asian Tigers directed to economic logic.

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<sup>106</sup> Wade, *op.cit.*, 228-233

- 1- The ideologies of the elites accommodated with the development policies
- 2- The fruits of economic prosperity shared not only among the economic world but also among the whole society.
- 3- The honest bureaucrats and economic technocrats were isolated from the political pressures.

Professor Dwig Perkins<sup>107</sup> explains the isolation of the honest technocrats from political pressures as follows:

The Far East countries were aware that, if they were not succeed in the economic development, the external powers would assimilate the communities. In South Korea the political power based on the army. In Taiwan political power based on the army and the party elites who were isolated from the pressures of the community. In Singapore the community believed the benefits of the social and economic prosperity, and supported development strategies.

The elites of Far East countries did not poison the politics and the economic development while the elites of Philippines and South America did poison the politics and economic development. In many developing countries like Philippines and the countries of South America, the pressure of the elites on the political authority were in the direction of maximizing the benefits of groups which they were representing. As a result of this the political logic dominated economic logic. The fruits of economic growth did not shared among the whole society. Because of these reasons cultural and social deformation took place, which poisoned the politics and economic development. In one way or another, the Far East countries understood and accepted the importance of sustainable economic growth. Therefore they escaped from political decisions, which may put barriers against the economic development.

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<sup>107</sup> Dwight H Perkins, **There Are At Least Three Models Of East Asean Development**, World Development Report Volume 22, 1994, pp: 5-16



Another main advantage of the Far East countries was the ethnic homogeneity. Ethnic divergence of the African and Middle East countries opposed economic development.<sup>108</sup>

Besides the four tigers (Singapore, Hong Kong, Taiwan, South Korea) there are other countries, which had reasonable success in the economic development. The development of those countries based on special factors. Therefore it is not possible to generalize their development strategies. For example, Israel adopted very different economic development strategy, which based on the American aids, the aids of the Jews from other countries and the indemnity payments from German Government. Like the Asian Tigers also Israel supported key-industries.

It is important to get an information about the development strategies of South Cyprus, before offering any development strategy for TRNC and the next section is devoted the development strategies of South Cyprus.

### **3.7. The Cyprus Experiment**

Cyprus gained independence in 1960. The newly formed government of the Republic of Cyprus inherited an economy, which exhibited most of the weaknesses of underdevelopment. The productive base of the country was inadequate, and economic activity was dependent upon unstable factors. Agriculture was dominant sector of the economy and subjected fluctuating weather conditions and characterized by low productivity. The island's small manufacturing activity was essentially restricted to the processing of locally produced raw materials and some specialized in handicrafts. The weak and small manufacturing sector centered on small family firms. Tourism was limited to a few hill resorts. The country's infrastructure was that of a third world country. Hidden unemployment and underemployment were widespread and mass emigration was taking place.

After the independence the Cyprus Government accepted that, the market system alone would not be able to provide the basis for major structural changes and for intensive infrastructure building and decided that economic planning is necessary. The

<sup>108</sup> Kotler, *op.cit.*, 69-70

government adopted a system of indicative planning, setting goals for economy and seeking to encourage and support the private sector's efforts to reach those goals through legislation and monetary and fiscal policies. In addition the state spent substantial resources to improve the country's physical and institutional infrastructure. Planners believed such measures would be sufficient for the island's dynamic private sector to function well and reach by itself the selected goals, with minimal government participation in day-to-day operation of the economy. Indicative planning was managed by planning bureau, aided by expert advice from abroad.<sup>109</sup>

The strategy, objectives, targets and economic policies programmes were embodied in "Five-Year Development Plans". The primary objectives of the "First Five Years Plan"(FFYP), which covered the period 1961 – 1966 was the upgrading of the economic and social infrastructure and the restoration of confidence to the economy.

During the application of FFYP, the Cyprus Problem started in the year 1963 in between Turkish and Greek communities of Cyprus. The government structure of Cyprus was functional federation and the two communities were the partners of this functional federation. As a result of the events started in 1963, the Turkish community was out of the government administration until the Turkish Peace Operation in 1974. During this period the Turkish Community survived by the aids from Turkey in small towns and villages which were surrounded by Greek community. The government, which constituted from Greeks, was accepted by the United Nations as the legal representative of Cyprus.

The Planning Bureau did not make any change in the FFYP but took the Turkish community out of the plan. The FFYP was successful. Price stability, improved balance of payments, and greater economic equality between rural and urban areas achieved. The plan provided public investment expenditure 62 million Cyprus pounds on development projects for roads, airport facilities, irrigation projects and telecommunications and electricity systems. The Agricultural Research Institute was established in 1962 to improve the quality of agriculture. The Central Bank ensured the

<sup>109</sup> <http://www.Lcweb2.gov/frd/cs/cytoc.html>, **Cyprus – A country Study**, Federal Research Division, Library of Congress, Edited by Eric Solsten, January 1991



appropriate volume of credit available to the private sector. The first plan achieved remarkable success, most obviously in agricultural production.

The "Second Five Year Plan" (SFYP) for 1967 to 1971 moved beyond the fundamental approach of the first plan, seeking to provide the social and legal structures needed by more advanced economy. It also gave the business community a more active role in planning. The main objectives and targets of the first and second five years plans were achieved and the GDP grew at average annual rate of about 7% in real terms. Gross fixed capital formation increased from 18% of GDP in 1961 to 28.5% in 1973. Unemployment was contained to a low level and reached 1.2% in 1973.<sup>110</sup>

The "Third Five Year Plan" (TFYP) for 1972 to 1976 stressed regional planning to promote more even economic growth throughout the island. This plan also concerned itself with the social and structural aspects of development. The Cyprus Development Bank was established to provide medium and long-term loans for development projects, as well as technical and administrative assistance. The Higher Technical Institute and Hotel and Catering Institute were established to provide specialized training.

The success of these plans shown by the great gains the Cypriot Economy made the first fourteen years of independence. Although agriculture had become much more productive, the secondary (manufacture and construction) and the tertiary (tourism and trade) sectors had shown even a grater productivity as Cyprus became a more developed nation. The share of agriculture in GDP declined from 26.3% in 1960 to 17% in 1973. While the share of manufacture and construction expanded from 19.5% to 25% and the share of tourism and trade expanded from 25.2% to 58%.<sup>111</sup>

The Turkish Peace Operation in 1974 divided island in two parts. Turkish community gathered in the north on an area of about 36% of the island, which was occupied by Turkish troops. The Greek community was gathered on the rest of the island in south. The United Nations continued to accept the Greek administration in south as the legal representative of whole Cyprus.

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<sup>110</sup> Ibid.

<sup>111</sup> Ibid.

### 3.8. The South Cyprus Experiment

The economy of Cyprus was divested in 1974. About one third of the population of both communities became refugees. The lost northern part of the island contained raw materials, agricultural resources, and important infrastructure facilities such as the Nicosia International Airport and the island's largest port Famagusta. The need for reconstruction and development was critical. To meet this challenge, a series of "Emergency Economic Action Plans" (EEAP) for two years period was instituted.

The first and second EEAPs, covering the period from 1975 to 1978 aimed mainly at aiding the refugees, then living in camps, by establishing a housing program for them. The plans also directed the government to stimulate the economy by adopting expansionary fiscal and monetary policies. The results were positive. The economy expanded by about 6% per year and unemployment rate declined to about 2% in 1978. Increased domestic consumption and rising prices, however produced some overheating of the economy, the inflation rate reached 7.4% in 1978.<sup>112</sup>

The impressive growth performance was based on number of exogenous factors, such as the booming Arab markets, the Lebanese crisis of 1975, favorable weather and high international market prices for some major Cyprus agricultural products, provided the impetus that lifted the economy. An additional element was foreign aids, which helped to bridge the financing gap. However, success had its price, since the increased dependence of the country on foreign financial resources was translated into a relatively large and growing foreign debt and inflationary pressures. Internally, the aggressive and expansionary fiscal and monetary policies, the entrepreneurial capacities of Cypriots which exploited the arising export opportunities, the acceptance by trade unions of a substantial cut in wages, formed the front which led the economy to the path of recovery. Furthermore the adoption of a labor-intensive strategy and policy to encourage the temporary employment of the Cypriots abroad helped ease the unemployment problem.

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<sup>112</sup> Ibid.



The Third EEAP covering 1979 to 1981 (the last of two years plan) aimed at countering the overheating of the economy by adopting a restrictive monetary policy. The main goal of the fourth EEAP covering 1982 to 1986 was to balance economic expansion with monetary stability. These goals were reached. High growth rate with low unemployment continued.

The need to stimulate the economy after the division of the island in 1974 caused the government to abandon the old policy of balanced budgets and adopt expansionary fiscal and monetary policies. The results were large and widening budget deficits paid by borrowing at home and abroad. Domestic public debt rose from 7.5 million Cyprus pounds in 1976 to 161.5 million Cyprus pounds in 1988. Public and publicly guaranteed foreign debt increased from 61.8 million Cyprus pounds in 1976 to 602.5 million Cyprus pounds in 1988. In 1988 the total public and publicly guaranteed domestic and foreign debt was 38.7% of GDP.<sup>113</sup>

A specific look at government public finance shows that the Republic of Cyprus maintained three types of budgets. The ordinary budget, which included expenditures for government operations and other current expenses, the development budget which included development programs and the special relief fund which covered state aid for the housing and care of refugees. The major source of revenue of the ordinary budget included direct taxes, indirect taxes, loan proceeds, sales of goods and services and foreign grants. The major expenditures of the ordinary budget were salaries, fees and allowances, public debt charges, contributions and subsidies. There was no revenue in the development budget during the period of 1976 – 1987, because there had been no public savings in the ordinary budget. Thus the development budget had to rely on domestic and foreign borrowing to cover the expenditures. The major expenditures of the development budget were investments, capital transfers and land acquisition. Investment expenditures were mainly financing the infrastructures. (Highways, airports, seaports, etc)

The south Cyprus successful economy kept unemployment rates low. During the 1980s unemployment rose above 3.3% only once when it reached 3.7% in 1987.

<sup>113</sup> Ibid.

Unemployment rates were also low in the years just before the Turkish Peace Operation, averaging 1%. The operation disturbed the economy and unemployment averaged 16.2% in 1975 and 8.5% in 1976. During 1977 the unemployment rate fell 3%, a rate typical for the south's economy during 1980s.<sup>114</sup>

The south's economy frequently had contend with a shortage of workers and in some years was forced to import workers from abroad to meet the needs of various sectors, especially the tourist industry. The only population group that had difficulty finding employment was composed of university graduates. Their discontent sometimes resulted in demonstrations and demands that civil service be expanded.

After the application of Cyprus for the assessment to EU the targets of the plans took into account the constraints facing Cyprus economy as well as the Maastricht Convergence criteria. More specifically it is anticipated that the GDP will grow an average annual rate of 4% in real terms, the unemployment will be restrained below 3% of the economically active population and the inflation rate will fluctuate at around 2.5%. The deficit of the current account balance of payments expected to stabilize at a level which can be financed by nondebt funds, while fiscal deficit is anticipated to decrease to less than 3% of GDP.<sup>115</sup>

The application of Cyprus to EU took place in 1990 and assessment talks started 1995. The main goal of economic planning was the convergence of the Cyprus economy to EU economy. The new development plan which will cover the period of 1999 – 2003 has further aims than convergence and of particular importance for economy, in view of the globalization of the economies, the liberalization of trade, the rapid technological changes, as well as the envisaged accession of Cyprus in the EU. All these development will result in intensification of competition both in local and foreign markets. Taking into account these challenges, the main strategic objectives of the new plan are foreign markets. The acceleration of the harmonization process with the conditions prevailing in the EU.

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<sup>114</sup> Ibid.

<sup>115</sup> Ibid.



- The achievement of highest possible rate of growth, while preserving the same time, conditions of macroeconomic stability.
- The restriction of all the sectors of the economy the modernization and the technological upgrading of the productive units, the exploitation of the economy's comparative advantages, with a view to enhance the competitiveness of the Cyprus economy.
- The upgrading of the role of Cyprus as an international center and a service center of high quality.
- The improvement of quality of life and upgrading of the environment.
- The adoption of the economy to the emerging information society.
- The reform and the modernization of public services.<sup>116</sup>

Attracting foreign investors in all sectors of the economy with special emphasis on high technology constitutes one of the primary objectives of the government's development policy. Towards this end a Foreign Investors Service Center that operates under the Ministry of Commerce, Industry and Tourism has been set up. The Foreign Investors Service Center is expected to play a major role in attracting direct investment, which contributes to the introduction of high technology and new knowledge, through which restructuring and enhancement of competitiveness of the productiveness of the productive fabric will be achieved. More specifically the Center:

- Provides information to investors regarding financial, legal and taxation matters in implementing a project in Cyprus.
- Provides advice to potential investors regarding the most effective way of making use of the package of various benefits offered (e.g. grant schemes)
- Is responsible for examining applications submitted to the Central Bank of Cyprus for projects in manufacturing, trade, tourism and energy sectors.
- Acts as a liaison with various government departments and facilitates the acquisition of the required permits/approvals.

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<sup>116</sup> [hppt//www.pio.gov.cy](http://www.pio.gov.cy)

### 3.8.1 Agriculture

When Cyprus achieved independence in 1960, the backbone of its economy was agriculture, mostly small firms and sometimes even subsistence farms. During 1960s irrigation projects made possible vegetables and fruits exports, increasingly commercialized farming was able to meet the demands for meat, dairy products, and wine, from the growing number of tourists.

In the early 1970s the small owner-run farms of Cyprus furnished about 70% of commodity exports and employed one-third of islands economically active population. Given the expansion of the manufacturing and service sectors, however, agriculture's importance was declining and in the first half of the 1970s its share in GDP amounted by 18%.

The de facto division of the island in 1974 left Turkish Cypriot community in the north, in possession of agricultural resources that produced about four-fifths of the citrus and cereal crops, and all of the tobacco. The south retained nearly all of the island's grape growing areas and three-fourths of valuable potato crop and other vegetables (excluding carrots). The Turkish peace operation caused a large-scale uncoordinated exchange of the agricultural work force between the northern and southern zones. The resulting substantial agricultural unemployment was countered by the government actions that included financial assistance on easy terms to farmers. By 1978 the number of persons working in agriculture in south Cyprus was 47000 or 23% of the working population. Thereafter agriculture's portion of the work force declined to 20.7% in 1979 and 15.8% in 1987. Its contribution to the economy also declined from 17.3% of GDP in 1976 to 10.7% in 1988.<sup>117</sup>

The share of agriculture in south Cyprus economy declined continuously. The South Cyprus economy become dominated by the service sector. The island's favorable climate and its location near its leading market Western Europe meant that farming would remain an important and stable part of the economy.

<sup>117</sup> <http://www.Lcweb2.gov/frd/cytoc.html>. op.cit.



The government encouraged agriculture because it provided rural employment, which maintained village life and relieved urban crowding. Small-scale agricultural activity prevented some regions from losing much of their population. Part-time agricultural work also permitted urban residents to keep in contact with their villages and gave them supplemental income.

The broad agricultural sector contributed in 1997 4.3% to GDP and employed 30000 persons or 9.5% of the total economically active population. Agricultural exports were 30% of total domestic exports.<sup>118</sup>

Cyprus agriculture may be divided into two major sub-sectors namely crop production and livestock production, which, in 1997 contributed 58.2% and 25.4% respectively to the value added of the broad agricultural sector. The contribution of the other sub-sectors was as follows. Ancillary production (milk and grape products processed on-farm) about 5.9%, fishing 6.1%, forestry 3.4%.<sup>119</sup>

The development policy of South Cyprus aims restructuring and upgrading the broad agricultural sector. Gradual harmonization with Common Agricultural Policy (CAP) of the EU is basic objective as regards the agricultural sector. As regards to fisheries, the basic reference point is the Common Fishery Policy (CFP). More specifically the main objectives are:<sup>120</sup>

- Increase of agricultural production and improvement of the broad agricultural sector, taking into consideration a balanced development of agricultural sub-sectors, with emphasis to competitive sub-sector products.
- Approaching agricultural holdings/areas/zones as integrated units and preparation and implementation of integrated development programmes based on common socio-economic, soil and climatic characteristics. Areas may be grouped in two main categories or zones i.e. the 'Plain'

<sup>118</sup> <http://www.cyprustrade.gov.cy>

<sup>119</sup> *Ibid.*

<sup>120</sup> <http://www.pio.gov.cy>

and 'Mountainous' Agricultural Zones, each one with its own development targets, capabilities and prospects.

- Improvement of farmer's standard of living.
- Maintenance of balance of market (supply – demand) of agricultural products.
- Sustainable agricultural development, taking into consideration the preservation of the environment and minimization of negative effects from agricultural activities on the environment.
- Harmonization with the EU, with basic reference points the CAP and CFP.

The targets of on-going development programme are satisfactory rates of growth of exports, gross agricultural output and value added of the broad agricultural sector while productivity is expected to increase at a relatively high rate that will reduce unemployment in the sector. In order to attain the above objectives, the government implements various programmes and projects. An essential component of many of these projects are the provision of agricultural credit, subsidies and other assistance for the purpose of encouraging the development of agricultural sector while supplementing agricultural incomes.

### **3.8.2 Tourism**

After the achievement of independence in the year 1960, the government of the newly established republic, realizing the vital role tourism could play in diversification and restructuring of the economic life of the island, placed a high degree of priority on the tourist sector. The emphasis was mainly on the development and expansion of the tourist product and gaining for Cyprus a top place among its Mediterranean competitors.

By 1970, Cyprus became a prestige destination center. Particularly the seaside was the favorite choice of the majority of holidaymakers. The tourist policy aimed at the high and middle-income tourists to the exclusion of mass tourism. As a result the majority of tourists belonged to the more sophisticated classes and were of mature age.



The annual average rate of growth in tourist arrivals before 1974 was of the order of 20% as against 8%, which was corresponding rate of growth of international tourist traffic. The annual rate of growth in foreign exchange earnings from tourism in this period was 22% compared to 12%, the figure for earnings from international tourism.<sup>121</sup>

Since the late 1970s the largest and most dynamic component of the service sector has been tourism. It grew at double-digit rates. Its contribution to GDP in current terms quadrupled between 1979 – 1988. By the late 1980s with about 50000 workers, it had also become the largest source of employment.

Tourism was seriously disrupted by the Turkish Peace Operation. However, under the influence of the emergency economic action plans of 1976 – 1978, 1979 – 1981 and 1982 – 1986, earnings from tourism increased at least 20% per year and the number of tourists who visited South Cyprus went from 165000 in 1976 to 1376000 in 1989. Earnings were so significant that tourism was a greater source of foreign exchange than exports of domestic goods. Most of the tourists who came to the South Cyprus were middle income Europeans. British visitors were the most numerous and made up about one-third of total. Most tourists came for stays of about ten days and arrived during the warm months. The Cyprus Tourism Organization (CTO) in the late 1980s began to be successful in increasing conference tourism to achieve a more even seasonal distribution of visits.<sup>122</sup>

A vital step by the government of the Republic of Cyprus was the establishment of the CTO in 1969. CTO's services have been extended over the years, and at present they include the Head Office Services in Nicosia and Regional Office Services. The former consists of four departments, i.e. the Administration Department, the Tourist Organization (Planning) department, the Tourism Promotion and Publicity Department, and the Tourist Service Department. The Regional Office Services consists of:<sup>123</sup>

<sup>121</sup> <http://www.Lcweb2.gov/frd/cs/cytoc.html>, *op.cit.*

<sup>122</sup> *Ibid.*

<sup>123</sup> <http://www.pio.gov.cy>

- i- Eleven tourism information offices located at the main towns or tourists centers at Larnaca and Paphos airports and the Port of Limassol, which provide assistance and information to visitors,
- ii- Six Inspectors' Offices,
- iii- The Larnaca Marina Services,
- iv- Sixteen tourist offices maintained in London, Frankfurt, Paris, Stockholm, Athens, Zurich, Milan, Amsterdam, Brussels, Vienna, New York, Tokyo, Tel-Aviv, Budapest, Warsaw, Prague. The role of these tourist offices is the marketing and promotion of Cyprus tourism, the servicing of the trade and the provision of information to prospective holidaymakers to Cyprus.

The government of Republic of Cyprus, though the CTO, participates actively and makes a constructive contribution to international tourism organizations such as World Tourism Organization (WTO), the European Travel Commission (ETC), the International Congress and Convention Association (ICCA), the European Federation of Conference Towns (EFCT), the Middle East Mediterranean Travel and Tourism Association (MEMTTA), the Mediterranean Tourism Network and others. South Cyprus regularly represented at the annual meetings of the European and North American national or international travel trade associations such as the British ABTA, The German DRV, the French SNAV, the American ASTA, the UFTAA and others. CTO's other activities include participation in overseas exhibitions seminars on tourism<sup>124</sup>.

By the end of 1980s efforts were underway to raise the quality rather than the quantity of tourism because the South's ability to receive more tourists reached saturation. The volume of demand had surpassed the available infrastructure to support it, with resulting problems of traffic congestion, water shortages and inadequate sewerage capacity.

By the end of 1990s the number of beds in operation totaled 59271<sup>125</sup>. The increasing rate of bed capacity led to the approval by the cabinet in cabinet in late

<sup>124</sup> Ibid.

<sup>125</sup> Ibid.



November 1990, of new tourist policy, which aimed at slowing down the rate of growth of beds and gradual upgrading of tourist product. Although the rate of new application of new establishments was reduced drastically as a result of this policy, the supply of beds by the end of 1998 reached 86151 due to the big number of approvals granted to the imposition of the new restriction measures.<sup>126</sup>

In general, effort for the upgrading of tourism great emphasis is placed on the further development of particular forms of tourism, such as conference tourism, winter tourism, agro tourism and special interest tourism. Their development and expansion can potentially alleviate the present problem of seasonality and may be a step towards a more rational utilization of bed capacity, which could lead to a balanced disbursement of accommodation.

A new chapter in South Cyprus Tourism is the programme for the development of Agro tourism / Rural Tourism in South Cyprus. The programme, as designed and launched by the CTO, encourages the conversion of traditional houses in the picturesque villages of hinterland for tourist use (accommodation, establishments, taverns, restaurants, cultural centers, handicraft centers etc.) A significant number of traditional houses have already been converted into accommodation establishments in accordance with the relevant regulations under Hotel Law, further to Town Planning approval and building permit and received their classification and operation license from CTO. The "Cyprus Agro tourism Company" a non-profit organization, which draws its membership from owners of traditional houses has established in 1996, to help coordinate individual marketing and incoming bookings. To this end, the Cyprus Agro tourism Company is in the process of setting up a Central Reservation Office with a Central Reservation Systems and an Internet web site that will provide the company with the capability to accept real time bookings. Furthermore, the Cyprus Agro tourism Company has also produced two interesting publications. The one, which is the basic promotional tool of agro tourism product, is an attractive pamphlet, with general information on the product itself. The other is Traditional Homes Guide, which provides detailed descriptions of 40 such homes, combined with information on villages that host them. In all, in the face of Agro tourism, a promising sustainable tourist product is being

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<sup>126</sup> **Ibid.**

developed. In fact, the potential of agro tourism in South Cyprus was dully recognized by British Airways, which presented the South Cyprus Agro tourism Programme with the European Winner Award of prestigious 'Tourism of Tomorrow' award.<sup>127</sup>

The basic aim of the official tourist policy is the increase of the contribution of tourism in the economic and social development of the country within the long-term development potentialities of the sector. In fact, during the past few years the development of the island increased considerably. However, the prospects of obtaining in the future the same level of tourist traffic depend on various internal and external factors. On the domestic side, a number of problems have been created by the rapid growth rates of tourist development. The exogenous factors, on the other hand, have their origin in economic difficulties that some of countries or origin of the island's tourist traffic may be facing. In view of these problems and in order to continue to attract tourists from relatively high-income groups, the main goals of official tourist policy for the coming years are curtailment of high rates of growth in bed supply and improvement, enhancement of the tourist products.

South Cyprus trade balance has been consistently unfavorable since before independence. Given its large and expanding trade deficit. The Republic of South Cyprus was fortunate to have a large and growing surplus in its invisible account, enough even to offset the trade deficit. The major factors contributing to this surplus were tourist receipts.

### **3.8.3 Manufacturing**

At independence the manufacturing sector consisted almost entirely of small, family-owned enterprises, most with fewer then five workers. Production consisted mainly of consumer goods and items for the construction industry all for the local market. Obstacles to the development of larger establishments were limited domestic market, a generally low level of income, a lack of available capital, and shortage of skilled labor.

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<sup>127</sup> Ibid.



During the period of the SFYP (1967 – 71) steps were taken by the government to encourage industrial development. Import duties on raw materials were reduced or abolished, and tariffs were imposed to protect domestic industry. Generous depreciation allowances and tax remissions were granted. In addition, training centers were set up for management, technical personnel and workers. Industrial parks were established in Nicosia, Limassol and Larnaca. Government policy generally left manufacturing to private enterprises, but in some cases, such as the petroleum refinery at Larnaca, the government made direct investments.<sup>128</sup>

During the plan period, larger manufacturing plants were constructed. These plants included petroleum refinery, biscuit and margarine factories, fruit and meat canning plants, a brewery, an edible oil plant, paper product factories, textile and hosiery mills, pharmaceutical plants, and metal fabricating plants.

Before the Turkish Peace Keeping Operation, manufacturing as a whole, remained largely geared to local market, principal exception being canned goods, most of which were exported. The operation resulted in major division of island's manufacturing sector, because one-third of the larger enterprises were located in north. Another immediate effect was disruption of domestic market. The division also cut off the sources of some raw materials and intermediate goods.

The sharp general drop in incomes in the south after mid-1974 forced the manufacturing industry to reorient production toward exports. A principal objective of the FEAP (1975 – 76) was reactivation of manufacturing with emphasis on the development of labor-intensive industries such as clothing and footwear aimed at the export market. This effort also included measures to reestablish in South the operations of entrepreneurs who had the Turkish Cypriot Zone. During this plan period 200 new or reopened plants went into production, and at the end of the period more than 130 additional ones under construction.<sup>129</sup>

<sup>128</sup> <http://www.Lcweb2.gov/frd/cs/cytoc.html>, op.cit

<sup>129</sup> Ibid

The Greek Cypriot government took other steps to create an export climate attractive to the industrial entrepreneurs. Raw materials and machinery imports were duty-free, a guarantee scheme was established for bank credits for exports, and a tax allowance was granted on foreign exchange earnings from exports. Trade centers were also set up abroad and there was participation in foreign exhibitions. The exports of manufactured goods tripled in the period of 1975 to 1978. During the decade 1979 – 1988 the contribution of manufacturing to GDP at current prices nearly tripled. Manufacturing's share of GDP however declined slightly during the period beginning in 1984. The decline moved manufacturing into second place, after the category of wholesales and retail trade restaurants and hotels<sup>130</sup>

The principal industrial products were food, beverages and tobacco, textiles, wearing apparel and leather, paper and paper products, wood and wooden products, chemicals and toiletries, petroleum, rubber and plastic products, cement and metal products and equipments.

Industrial output came to dependent on exports. The Arab Middle East was a key market for industrial production but the EEC purchased 39.3% <sup>131</sup>of exported manufactures in 1987. These two markets and the protected domestic market absorbed about 90% of manufactured products. The traditional markets for Cyprus manufactured goods could not be regarded as secure at the beginning of the 1990s. The Arab Middle East markets were often highly volatile, for both political and economic reasons, and the European market had also become increasingly competitive. A main threat to Cypriot exports in these areas were Asian manufacturers with lower labor costs and higher quality goods. The domestic market was also increasingly threatened because of the Customs Union Agreement with the EU required the country to gradually dismantle its highly protective tariff system. In meeting these mounting challenges, Cypriot manufacturers were striving to raise the quality of their production, improve marketing and contain labor costs through productivity gains as tariffs came down. The government continued its longstanding policy of encouraging manufacturing by

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<sup>130</sup> <http://www.cyprustrade.gov.cy>

<sup>131</sup> *Ibid.*



improving the infrastructure and creating industrial parks and free industrial zones. It also identifies new industries and products suitable for future development.

The manufacturing industry of South Cyprus has been going through difficult times in recent years, experiencing at times a fall in the growth of production, exports and employment. The development has been result of erosion in competitiveness of South Cyprus, both abroad and in the local market, due to rising costs of production and insufficient productivity gains, at the time of increasingly intensified international competition. At the root of these problems lie the structural weakness of the sector, the low level of investment in the technology and low capacity utilization. It should be stressed however, that this is a phenomenon experienced in many industrialized countries. In spite of these problems, the manufacturing sector continues to be very important to the economy of South Cyprus, accounting 12% of GDP and 16% employment.<sup>132</sup>

A vital component of South Cyprus industrial strategy since 1974 has been to diversify and broaden the economy's industrial base. Increased use of skilled labor and more advanced and diversified technological input has been identified as key to success in this endeavor. Attention has been focused on the need to strengthen existing enterprises by improving their structure. The creation of linkages between local industries in order to increase the domestic value added of manufacturing output is another central aim of the government policy. In summary investment growth is being sought especially in:<sup>133</sup>

- a- Capital intensive and high technology units producing quality products for high-income groups.
- b- Enterprises producing high value added goods, which incorporate skilled labor or increase the degree of processing of local raw material exported.
- c- Units, which promote either forward or backward linkages, or are designed to achieve great specialization.

<sup>132</sup> Ibid.

<sup>133</sup> <http://www.pio.gov.cy>

- d- Industries which are non-intensive in energy use and do not create pollution or irreparable destruction of the environment.

The restructuring of production units, so as to give more emphasis to high quality, high value added products, the adoption of modern methods of production and management and the increase in productivity is becoming more urgent, on account of liberalization of trade brought about by Customs Union which the EU and new GATT agreement.

### 3.9 The Ireland Experiment

In December 1921 a treaty is signed which gave independence to Ireland, which is now called Republic of Ireland. The treaty of 1921 was not accepted by all and a Civil War took place between 1921 and 1923. During the period up to 1932 the emphasis was on establishing a framework of democratic government.<sup>134</sup>

Ireland was dependent on its larger island neighbor, Great Britain, for centuries up to 1921 when it achieved a measure of independence. Even then, however, strong economic linkages remained particularly in relation to trade.

At independence, Ireland was heavily dependent on the agricultural industry. Agriculture was in an underdeveloped state. Much of the land, particularly in the western half of the country was poor and holdings were fragmented. There had been little in the way of technical advances and incomes were low. Therefore the primary aim of economic policy during the early years of independence was to raise agricultural production and incomes and to encourage the export of agricultural products. Free trade was regarded as essential if the costs of farm inputs were to be kept low. On the other hand, price support for agricultural products became consistent feature of policy from early 1930s. Little attention was given to industrial development during the 1920s and 1930s. Reflecting the limited development of industry and industrial policy, output and employment growth were weak. Despite the emphasis on agriculture, farm incomes remained static, unemployment was rising and emigration was greater than in either decades.

<sup>134</sup> Frans Somers *European Union Economies* Essex, Addison Wesley Longman, 1988, pp: 184-200



The Great Depression influenced most countries to erect tariff barriers. The government immediately embarked on a strong protectionist policy. The motivation was partly to reduce economic dependence on Britain and encourage self-sufficiency and was also aimed to increase employment and to reduce emigration. The 'Economic War' between Britain commenced. Britain reacted by imposing duties on imports of Ireland's main agricultural exports. The Irish government in turn imposed duties on a further range of goods. The ending of the economic war with Britain in 1938 was however followed by the second war and the Irish high tariffic regime remained in force for several further decades.

These various policies proved effective in protecting and developing new industries as well as expanding other ones and helped Ireland to secure substantial growth of employment during particular periods. Thus manufacturing employment grew by 40000 between 1931 – 1939 and by further 41000 by 1953. However employment growth was to be short-lived and the numbers employed in manufacturing fell between 1953 and 1958. Furthermore the new firms tended to be small-scale units, lacking specialization, research development and marketing skills. A strong import propensity accompanied by little attention to exports (despite the small domestic market) and poor export performance, also resulted in recurrent balance of payment difficulties in the late 1940s and 1950s.<sup>135</sup>

From the late 1940s there had been a recognition of difficulties of relying unduly on the protectionist and self-sufficiency policies, which characterized the post-independence decades. Whatever the advantages of such policies, they were not creating sufficient job to stem the tide of emigration. An export orientation, invariably reduced in small open economy was not being achieved. Therefore in 1956 the Export Profit Tax Relief Scheme was introduced, whereby manufacturing firms were to be freed from taxation on profits earned on export sales.

The first programme for economic expansion (1959 – 1964) emphasized the need for productive investment. It favored the dismantling of tariffs and incentives to

<sup>135</sup> *Ibid.* p.186

promote industrial development. The emphasis in the future was to be on outward-looking and export-oriented policies, which attempted to attract foreign companies to Ireland and abandoned protectionism. During subsequent decades, this approach was to continue and included the cutting of tariffs, the repeal of the Control of Manufacturers Acts, the signing of an Anglo-Irish Free Trade Agreement, joining GATT, and the European Community.

Apart from agricultural and industrial policy, Republic of Ireland has intervened in relation to a range of economic and social issues. Thus since 1960s expenditures on health, education, social welfare and housing has increased significantly. The state also either owns or has share in over 100 enterprises ranging from transport to electricity. In view of the relatively small tax base to fund expenditure, this has caused difficulties during some periods. Prior to 1970s Irish governments had aimed to balance current revenue and current expenditure and borrowing was used primarily to finance capital programmes. However the oil crisis in 1973 influenced the government to introduce current budget deficit. By 1987 the national debt became unsustainable. It became 125% of GNP and the interest payments became 10% of the GNP. Government expenditure was cut back as from 1987 and an attempt was made to widen the tax base. Borrowing for capital purposes was also reduced significantly. A number of wage agreements between governments, employers farmers and trade unions, also played a critical role in curtailing expenditure. All of these agreements accepted wage increases broadly in line with expectations on inflation.<sup>136</sup>

The effects of reduction in public expenditure and interest rates resulted decrease in current budget deficit and capital borrowing significantly. This 'fiscal stance' is broadly in accordance with that specified in Maastrich Treaty and the Irish public finances now compare favorably with that most other EU member states.

The composition of Irish trade has changed significantly in recent decades. For example, in 1961 live animals and food accounted for 61% of exports by 1995 this figure has dropped to 20%. At the same time, the exports of manufactured goods had increased significantly from 18% to 68%. About three quarters of these exports are

<sup>136</sup> Ibid. 189



accounted by foreign firms, which on average export about 86% of their production in comparison with 33% for indigenous Irish firms.<sup>137</sup>

The foreign firms export primarily high technology products and account for about 40% of European PC software production. By 1990 the UK took 75% of Irish exports, however the production had dropped to 28% by 1995. Over the same period the proportion of exports going to other EU countries increased from 7% to 40%. Exports to other non-EU countries likewise increased. The main influence on the diversification of trade has the role of foreign firms with marketing strategies designed to capture markets in Europe and further afield. The proportion of imports from the UK have also declined while the EU figure has increased although the changes are not as significant as in the case of exports. Ireland now enjoys a large overall balance of trade surplus and has done so since 1985. The most significant positive change in recent years has been the transformation of the current account from deficit on the balance of payments of 15% of GNP to a surplus of over 8% in 1993. This has been accounted for largely by strong export performance particularly among foreign firms. The exploitation of natural gas, which reduced energy import requirements and relatively low oil and commodity prices from mid-1980s, has also helped. Positive transfers from the European Union Common Agriculture Policy (CAP) and Structural Funds (SF) have also played an important role in improving Ireland's balance of payments position. In 1960 (using 1994 constant prices) agriculture accounted for 25% industry 30% and services 45% of total GDP. By 1994 these proportions had changed to 9%, 38%, and 53% respectively, indicating the structural alterations by sector over the period.<sup>138</sup>

GDP per capita compared unfavorably to the European average over a period of three decades from 1960s. However, significant changes have accrued in recent years and by 1995 Ireland had reached 90% of European norm. There are many reasons for this improvement. For example, policies, which facilitated low interest rates and modest wage settlements were critical to an improvement in Ireland's comparative position.

<sup>137</sup> *Ibid.* 191

<sup>138</sup> *Ibid.* 196-198

Ireland joined the European Community together with Denmark and UK in 1973. At this time, the Irish government placed considerable hope on the positive benefits of membership and stressed the role the Community could play in 'Regional Development'. A special 'Protocol' included in the Irish Treaty of Accession, referred specially to the need to reduce regional imbalances. With the accession of Ireland and the UK in 1973, structural problems and in particular, regional disparities began to assume considerable significance. In the case of Ireland the special protocol included in the Treaty of Accession referred specially to the need to reduce regional imbalances and by 1975 the Commission had established the European Regional Development Fund (ERDF) to tackle the problem. The need for social policy was also recognized in the EEC Treaty, which established the European Social Fund (ESF). At the time, the policy placed particular emphasis on training and retraining as a measure to alleviate the difficulties of workers facing redundancy and the problem of unemployment.

Irish gross receipts from EU each year have been many times greater than contributions to EU. The resulting net receipts were 14 billion Irish pounds over the period 1985 – 95. The net receipts represented almost 6% of Irish GNP during this period. The agricultural industry in particular has received significant transfers from the 'Guarantee Section' of the CAP amounting to well over 70% of total EU expenditure in Ireland throughout 1980s. In line with CAP reforms, this had reduced to 57% of total by 1995. The ERDF has assumed increasing importance in recent years. In Ireland ERDF is primarily concerned with the development of a range of infrastructure, industry and tourism receipts from this Fund increased from 7% of the total in 1985 to 18% in 1995. The ESF is spent mainly on retraining in an effort to tackle Ireland's unemployment problem. This Fund only a modest increase in its share of total (from 12% to 13%) over the period 1985 – 95. It may be noted that receipts from new Cohesion Fund (CF) had also increased recent years.<sup>139</sup>

Structural Funds, gave priority to promoting the development of less prosperous regions by doubling the level of EU funding for the period 1989 – 93. Five 'objectives' were set out in the new policy and less prosperous regions, including Ireland, Northern Ireland, Portugal, Greece, and parts of Spain and Italy were classified as 'objective 1'

<sup>139</sup> *Ibid.*, 199-200



regions. A recent study estimated that the increased resources from the structural funds over the period 1989 – 93 increased GDP in Ireland by 2,5% in 1993. The investment is also estimated to have generated in extra 30000 jobs in Ireland in the same year.<sup>140</sup>

While significant positive benefits have attached to Ireland's membership of the EU, there have also some disadvantages. For example, the Union's competition policy means that some measures, which formerly gave Ireland, a comparative advantage came under scrutiny and was eliminated. Thus the Export Profits Tax Relief Scheme (Which was central in attracting foreign firms to Ireland) was seen to be anti-competitive and was replaced in 1981 by a generous tax allowance. Membership of the Union has also exposed indigenous Irish firms to the rigorous of the market and while this is reasonable and justified from an efficiency viewpoint, many jobs have been lost in the process. On balance, however it can be concluded that the benefits of membership outweigh to the costs and Ireland remains strongly committed to further development of the Union.

While the employment in the service sector has risen, the scale of increase compares unfavorably with most European Countries. The Irish unemployment rate is among the highest in Europe and there is particular concern about the persistence of long-term unemployment. In the absence of various state employment schemes of a short-term nature, the real unemployment rate would be even higher. Despite the range of positive features and improvements in the Irish economy in recent years, it would be wise to face up to the fact that Ireland will continue to remain heavily influenced by international events and trends.<sup>141</sup>

Looking to future it seems that the European Union Structural and Cohesion Funds could play an important role in raising living standards, reducing unemployment, and exploiting more fully Ireland's economic potential. 'Planned expenditure over the period 1994 – 99 included 6200 million Irish pounds from Union Structural Funds, 638 million Irish pounds from Community Initiatives and 1150 million Irish pounds from new Cohesion Fund with constant prices of 1993. Irish government expenditure is planned to be 8500 million Irish pounds, while the private sector is predicted to spend

<sup>140</sup> **Ibid.**

<sup>141</sup> İstanbul Ticaret Odası, **Irlanda Deneyimi**, İstanbul, Prive Grafik & Matbaacılık, 2002, s:37-83

3700 million Irish pounds over the period. Total expenditure over the period of development plan is thus expected to be about 20 billion Irish pounds. The substantial funding from EU should help to achieve the plan's goals.

There is little doubt that Ireland is heavily dependent on trade with the outside world and quickly affected by and dependent on international developments. This is of course the case with all small open economies. Membership of European Union has significantly lessened Ireland's dependence on one single trading partner. Trade has diversified and membership brought other significant benefits. However the country remains heavily dependent on foreign investment.<sup>142</sup>

As regards the modernization theory, Ireland has undoubtedly changed in a relatively short period of time from being a relatively undeveloped agricultural economy to a 'modern' urbanized one, where manufacturing and services play a major role 'modernization' is largely attributable to foreign investment, including EU funding, and only in recent years that serious efforts have been made to develop a competitive indigenous industry. The rationale for these efforts stem from the realization that multinational companies operate on a global scale. While making an important contribution to Ireland's development effort, it would be unwise to rely unduly on them to resolve the most important problem of unemployment. The provision of adequate and viable employment and significant reduction in the level of unemployment remain fundamental difficulties to be resolved as a matter of urgency.<sup>143</sup>

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<sup>142</sup> *Ibid.*, s: 52

<sup>143</sup> Somers, *op.cit.*, p: 200



**Table 3.1 Comparison of the Strategies of Some Newly Industrialize Countries  
(First Period)**

<b>SOUTH KOREA</b>	<b>TAIWAN</b>	<b>HONG KONG</b>	<b>SINGAPORE</b>
Massive government intervention and control of the market	Agricultural reforms to increase the number of farmers who have their own field	Government gave direct supports to exports.	Import substitution policies.
Import substitution, defensive and at the same time export incentive industrial policies.	Massive government intervention and import substitution	Government directed companies to export markets through trade policy	Promotion of high labor content industries
Low prices given to agricultural products labor force shifted to industry	Import quotas for luxury goods	Government built up modern infrastructures for trade and export	Establishment of Economic Development Board (EDB)
Trade policy based on promotion of manufactured exports	Promotion of imports of industrial machinery	Concentrated intervention the scarce immobile market	Coordination and development of industrial activities
Government actively directed the growth of manufacturing sector	Concentrated supports on certain selected industrial production		

**Table 3.2 Comparison of the Strategies of Some Newly Industrialized Countries  
(Second Period)**

<b>SOUTH KOREA</b>	<b>TAIWAN</b>	<b>HONG KONG</b>	<b>SINGAPORE</b>
Changing the structure of production to catch dynamic advantages in the world market	Low interest rates and tax refunds for the exports	Government investments on new and developed communication and infrastructures	Leaving the import substitution policies
Encouragement of heavy and chemical industry	Removal of the beurocratic problems of investment	Modernization and liberalization of banking and finance laws	Increase in the promotion of industrial investments FDIs
Massive intervention of allocation of resources	Promotion of both domestic and FDIs	Quick improvement in financial sector	Economic Development Board EDB established
Government actively directed industrial diversification	Establishment of Export Process Zones (EPZs) to use imported materials and Taiwan labor force for export	Government opened Trade Development Centers in export markets to promote exports	Industrial Zones established for FDIs for exports to foreign market
Government directed banking sector to provide long term loans to the industry at low interest rates	Selling to domestic market from EPZs not allowed		



**Table 3.3 Comparison of the Strategies of Some Newly Industrialized Countries  
(Third Period)**

<b>SOUTH KOREA</b>	<b>TAIWAN</b>	<b>HONG KONG</b>	<b>SINGAPORE</b>
Export led growth production according to the world market	Agricultural reform in opposite direction to increase the amount of the field owned by the farmers	Giving free lands to the high technology companies	Changing promotions from high labor industries to high capital industries
Borrowing technology (importing the technology, adopting and developing	Mechanical farming and efficiency in agriculture	Establishment of industrial zones to high technology firms	FDI Policy changed from low wages to high skilled labor and high technology
Massive intensive to technology and research and development	Changes in science and education policy aiming new and high technology	Establishment of productivity centers and scientific parks	Computer industry, medical industry consultancy were supported
	Very strong patent law and research and development were supported		The skills and education level (Capacity) of human resources were increased
	Promotion of information. Automation, optoelectric and biotechnology		

**Table 3.4 General Strategies of Some Newly Industrialized Countries  
Which Applied In All Periods**

<b>SOUTH KOREA</b>	<b>TAIWAN</b>	<b>HONG KONG</b>	<b>SINGAPORE</b>
Government intervened the ownerships through Chaebols	Government intervened the ownerships through agricultural reforms	Government had excellent benefits from being the opening gate of China	Government applied and managed very clever FDIs policy
Foreign loans and special favors were given to the Chaebols	Dynamic and clever interventions to the economy	Government interventions limited with to regulate the market and to build up infrastructures	In order to attract the FDIs government invested to high technology, infrastructures and information technology
Selection of Industries which has to be promoted	Selection of Industries which has to be promoted	Government intervention to the immobile sector	Clever interventions and improvement of human resource capacity
Very conservative budgetary policy (balanced budgets)	Very conservative budgetary policy (balanced budgets)	Very conservative budgetary policy (balanced budgets)	Very conservative budgetary policy (balanced budgets)



**Table 3.5 Common Factors Which Helped The Quick Development of The Newly Industrialized Countries**

<b>INTERNAL FACTORS</b>	<b>EXTERNAL FACTORS</b>
Cultural foundation of the Far East (To be honest, dependence to the company, family structure)	Increasing demand of America and Europe to the imported goods
Concentrated government interventions	Developed countries transferred high labor content industries to the cheap labor countries.
Management of dynamic comparative advantages of the country	Foreign aids from USA according to the Marshall Plan
At the beginning import substitution for a short period	Foreign Direct Investments of the multinational companies
Starting to the industrialization with high labor content industries	
Increasing their experience both in the production and exports	
When the wages started to increase and they lost their cheap labor advantages they passed capital concentrated sectors	
The bureaucrats and the economic technocrats were isolated from the pressure of the politicians	

**Table 3.6 The Development Strategies of the Republic of Cyprus**

GENERAL REMARKS	GENERAL STRATEGIES
Cyprus Problem started in 1963. Cyprus Government didn't make any change in the economic development policy but acted as if there were no Turks and Turkish Regions in Cyprus	Market system alone would not be able to provide basis for major structural changes For structural changes and for infrastructure building economic planning is necessary
Turkish Peace Operation took place in 1974. Turkish Community gathered to the North Cyprus and Greek Cypriots gathered to the South Cyprus	Indicative planning Setting goals for the economy and seeking to encourage and support the private sector's efforts to reach these goals
The Greek Cypriot Government at South Cyprus accepted as the legal representative of whole Cyprus	Encouragement and support of the private sector through legislation and monetary and fiscal policies
The South Cyprus Government applied the economic development policies to the South Cyprus while enjoying being the legal representative of whole Cyprus	Minimal government participation in the day-to-day operation of the economy
South Cyprus applied to the membership of EU for the name of whole Cyprus in 1990 and started to the negotiation in 1995	The strategies, objectives, targets and economic policies and programmes were embodied in development plans



**Table 3.7 The Economic Development Strategies of Republic of Cyprus**

<b>FIRST PERIOD (1960-74)</b>	<b>SECOND PERIOD(75-89)</b>	<b>THIRD PERIOD (90 - ..)</b>
	<b>SOUTH CYPRUS</b>	<b>SOUTH CYPRUS</b>
Massive Government interventions on building new infrastructure	Massive government interventions on rebuilding new infrastructure and houses for refugees	Restrictive fiscal and monetary policies to balance economic expansion and stability
Price stability through macroeconomic policies	Expansionary fiscal and monetary policies to stimulate the economy	Convergence of South Cyprus Economy to EU economy in view of globalization of economies
Equality between rural and urban areas	Maximum benefits from external advantages such as Lebanese Crisis	Highest possible growth while preserving macroeconomic stability
Establishment of the social and legal structures needed by advanced economies	Clever management of foreign aids	Restructuring modernization and technologic upgrading of the productive units
Regional planning to promote more even economic growth	Agreement with trade unions of a substantial cuts in wages	Upgrading the role of South Cyprus as a service center of high quality
Assistance and long term aids for the development projects	Promotion of labor intensive industries	The improvement of quality of life and the upgrading of the environment
Very conservative budgetary policy	Promotion of FDIs and tourism industry	Adoption of the economy to the information society
	Three types of budgets, Ordinary budget, development budget, Social Relief Funds	The reform and modernization of public sector
		Attracting FDIs in high tech., Tourism and service

**Table 3.8 Development Strategies of Ireland**

<b>FIRST PERIOD(1930-56)</b>	<b>SECOND PERIOD(56-73)</b>	<b>THIRD PERIOD (73-...)</b>
The primary aim of the economic policy to raise agricultural production and to encourage agricultural exports	Outward looking and export oriented policies	Ireland joined to EU together with Denmark and UK in 1973
Price supports to agricultural products	Incentives to promote the industrial investments and exports	Special protocol included in the Irish treaty of Accession referred to the need of to reduce regional imbalances
Strong protection policies	Export Profit Tax Relief Scheme, no tax on profits earned from exports	Positive transfers from ERDF and from the CAP
High tariff barriers	Incentives to attract FDIs	The ESF spent efforts to tackle Ireland's unemployment problem
Import substitution and self sufficiency policies	Reduction in public expenditure and interest rates to decrease budget deficits and to obtain significant capital borrowings	Structural Funds of EU gave priority to promote the development of less prosperous regions in Ireland



### 3.10 Chapter Conclusion

The experiments of some countries, which have developed after 1960s, studied in this chapter. These countries are, South Korea, Taiwan, Singapore, Hong Kong (these are called NICs) and also Cyprus (then South Cyprus) and Ireland.

These countries used the opportunities of external factors, and applied very clever economic policies and in the second half of the twentieth century they developed very rapidly. In other words these countries applied very clever government interventions and had effective management of dynamic comparative advantages of the country.

Although each country applied her own unique strategy for development, the strategies of all of these countries has some common factors. These common factors are listed below and have to be accepted as basic factors of economic development in today's global economic world:

- 1- They used dynamic planning and rational government interventions as the main tools of economic development.
- 2- They started industrialization with high labor content industries and protected their industries. Then they passed export-led growth model and decreased protection.
- 3- They left the industries, which lost the comparative advantages in international market and passed new, and high technology industries and service production.
- 4- The bureaucrats and the economic technocrats were isolated from the pressure of the politicians
- 5- They applied very conservative (balanced) budgetary policies.
- 6- They applied very clever macroeconomic policies (fiscal and monetary policies) and balanced economic development and stability.

- 7- The skills and the education level of human resources increased according to the necessities of the economic development.
- 8- The basic human rights were provided and guaranteed by the legal system.
- 9- The costs of government interventions were controlled within the certain limits and the future benefits of the interventions were measured to be greater than the costs.
- 10- The elites did not poison the politics and the economic development. The ideologies of the elites accommodated with the economic development policies.
- 11- The fruits of economic prosperity shared not only among the economic world but also among the whole society.

Considering the experiments of these countries and also the theory of economic development and the small island economies an alternative development strategy for Northern Cyprus is introduced in the next chapter.



## **CHAPTER IV**

# **DEVELOPMENT STRATEGY FOR NORTHERN CYPRUS**

#### 4.1 General Remarks About The Strategy

The accession negotiations of Cyprus has completed and closed in the year 2002 between EU and 'Republic of Cyprus'. Although the 'Republic of Cyprus' has no rights and didn't represent Northern Cyprus in the negotiations. EU accepted 'Republic of Cyprus' as the representative of whole Cyprus and completed and closed the negotiations.

In the meeting of European Council in Copenhagen at 12 – 13 December 2002 following resolution was made about Cyprus:<sup>144</sup>

Cyprus:

10. In accordance with the above paragraph 3, as the accession negotiations have been completed with Cyprus, Cyprus will be admitted as a new Member State to the European Union. Nevertheless the European Council confirms its strong preference for accession to the European Union by a united Cyprus. In this context it welcomes the commitment of the Greek Cypriots and the Turkish Cypriots to continue to negotiate with the objective of concluding a comprehensive settlement of the Cyprus problem by 28 February 2003 on the basis of the UNSG's proposals. The European Council believes that those proposals offer a unique opportunity to reach a settlement in the coming weeks and urges the leaders of the Greek Cypriot and Turkish Cypriot communities to seize this opportunity.
11. The Union recalls its willingness to accommodate the terms of settlement in the Treaty of Accession in line with the principles on which the EU is founded. In case of a settlement, the Council, acting by unanimity on basis of proposals by the Commission, shall decide upon adaptations of the terms concerning the accession of Cyprus to the EU with regard to the Turkish Cypriot community.
12. The European Council has decided that, in the absence of a settlement, the application of the *acquis* to the northern part of the island shall be suspended, until the Council decides unanimously otherwise, on the basis of a proposal by the Commission. Meanwhile, the Council invites the Commission, in consultation with the government of Cyprus, to consider ways of promoting

<sup>144</sup> <http://www.ec-eu-delegation.com.cy/en/news/COPENHGN%20Conclusions.htm>



economic development of the northern part of Cyprus and bringing it closer to the Union.

This resolution will shape the future of Cyprus. The proposals of UN Secretary General aim to establish a new common government in Cyprus, which has two constituent states, namely the Turkish Component State in the North Cyprus and Greek Constituent State in South Cyprus.<sup>145</sup>

This thesis assumes that, a solution to the Cyprus Problem will be achieved. The solution will be based on the proposals of the UN Secretary General. A common federal government, which has two component states, will be established and TRNC will become the Turkish Component State in the North Cyprus.<sup>146</sup> Taking into consideration the proposals of UN Secretary General and the resolution of Copenhagen Summit, this thesis assumes that the common government of Cyprus will be an 'Economic and Monetary Union' (EMU) of two component states of Cyprus. After a short period this small EMU will make a large integration and the common government of Cyprus will make an EMU with the EU.

The aim of this thesis is to prepare a development strategy for TRNC, which will become the Turkish Component State of Cyprus, taking into account the future integrations. The strategy takes into account the dynamic changes in the domestic market while these integrations takes place. The dynamic changes in the European market are also considered.

The second main assumption of this thesis is, the progress of Turkey towards the EU will continue, the assession negotiations between EU and Turkey will be completed in future so that Turkey will become a member of the EU. The new Common Government of Cyprus will be in the 'Customs Union' with Turkey which already exists between the EU and Turkey.

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<sup>145</sup> UNSG, *Basis for Agreement on a Comprehensive Settlement of the Cyprus Problem*, 11 November 2002.

<sup>146</sup> *Ibid.*

## 4.2 Restructuring of Civil Services

There will be an iterative integration process. First an economic and monetary union between two component states of Cyprus will be established and in the same time a large integration between Cyprus and the EU will take place.

The first step is to reorganise the civil services of TRNC according to the new situation. A EU office has to be established at the level of deputy prime ministry. The functions of this office have to be as follows:

- Collecting information about the EU and the organizations of the EU.
- Adopting the regulations of TRNC to the regulations of the EU.
- Contacts with the EU
- Proposals of the necessary changes in the laws and regulations for the applications of the 'acquis'
- Preparation of necessary plans projects for the EU, finding the funds from the EU and making the applications.
- Arranging necessary derogations with EU during the transition periods until the GDP of the Turkish Component State of Cyprus will reach to the level of the Greek Component State of Cyprus.
- Training the society about EU
- Convergence of Copenhagen and Maastrich criterias

The SPO of TRNC has to be re-organized. The facilities of the statistical department have to be increased so that the statistical information of each period has to be ready before the end of next period and the information has to be reliable. The policy has to be changed and 'Indicative Planning' has to be accepted. The facilities of this department have to be increased for this purpose. Enough skilled experts have to be employed for preparing indicative plans.

'Indicative Planning' is planning the economy without interrupting the day-by-day operations of the economy. The sectoral structural policies, and also the fiscal policies of the government are arranged so that to indicate the sectors according to the development plans. Government prepares the infrastructures for the investments of the private sector. Government does not make any investment unless those huge projects



which private sector do not invest. Although it is not advisable to interrupt the competition system of the market economy, the government has to show the directions of new market dynamics to the companies. Also the government has to regulate and modification the market system. This needs an effective 'Indicative Planning'.

The Ministry of Economy has to be reorganized. Ministry of Finance and Ministry of Tourism has to be abolished and these three ministries have to be combined under the name of Ministry of Economy and Tourism. The departments of the Ministry of Economy and Tourism will be as shown below:

- The Trade Department, which will deal with the domestic and international markets.
- The Industry and Energy Department, which is related with the industrial production and energy production, and will operate to transform the industry according the new market conditions.
- The Tourism Department, which will be related with the tourism, collecting information, planning, marketing and also granting support to the tourism development projects.
- The finance department, which will be related with the banking system and the finance market and granting support and subsidies through the Development Bank
- The Service Department, which will be related with the service production, mainly university education and also new and advantageous products which are suitable to the Turkish Component State of Cyprus.
- Other offices such as Budget Office, Treasury Office, Tax Office, Customs Office.

The other ministries have to establish a EU unit in each ministry. The EU units have to prepare the necessary proposals for the related laws and regulations to 'acquis'. Also these units have to prepare necessary projects for EU. The economic organization of TRNC is shown in the figure 4.1 and the offered economic organization of the Turkish Component State of Cyprus is shown in the figure 4.2

The dynamic comparative advantages of each sectors has to be examined and 'Sectoral Planning' has to be made by the SPO. The sectoral adaptations according to the new market conditions have to be made by the various departments of the Ministry of Economy and Tourism. The defends and incentives has to be arranged and reorganized according to the regulations of EU by joint operations of Deputy Prime Ministry for EU and the Ministry of Economy and Tourism. Export-led economic growth model has to be accepted and applied through indicative planning process.

The work-force relations and the efficiency studies in the civil services have to be made by the State Efficiency Office. The economic bureaucrats and technocrats have to be isolated from the pressures of the politicians. The merit-bases progress system in the civil services has to be established.

The Turkish Component State of Cyprus (TRNC) must have two different budgets. The First would be the 'General Budget' related with the revenues and expenditures of public services. The 'General Budget' has to be balanced. In other words very conservative budgetary policy has to be accepted and the civil services never spend more then their revenues. The tax regulations, the types of taxes and the level of taxes have to be arranged according to the EU regulations and levels. The levels of taxes, which will be collected by the component states, would never be above the level of the same taxes of Greek Component State of Cyprus. Also the tax revenues, which will come from the Common State, will be the revenue of the 'General Budget'.

The second budget would be 'Development Budget'. The finance of the development of the Turkish Component State of Cyprus will be made through this budget. The 'Development Budget' will operate until the GDP of two component states of Cyprus will be equal. The revenues of the 'Development Budget' will be the aids from the EU and from Turkey, a percentage of tax revenues (between 10 – 15 %) transferred from 'General Budget'. The expenditures of the 'Development Budget' will consist the building and improving the infrastructures, the aids incentives and subsidies to the different sectors. The 'Development Board' which will be directly related to the Prime Minister and composed from the representatives from SPO, Ministry of Economy and Tourism, Ministry of Public Works and Transports, Ministry of Employment and



Social Security, Ministry of Agriculture, Ministry of Education and sectoral representatives from tourism, industry, trade, banking, university education and agriculture. The aids, incentives and subsidies will be injected to the private sector through the Development Bank and will be inspected by the Development Board. The Development Board has to calculate and apply the incentives so that the future benefits of the incentives to the economy should be greater than the present costs to the economy.

The social security system has to be reorganized. The social security reserve funds have to be closed. A simple tax-based 'Social Security System' has to be applied. Every educated person after graduating from university and others who are above twenty has to pay around 10% of their salaries or wages as social security tax. The social security tax of the unemployed will be paid by the government as the same percentage of the minimum wage. The age of retirement would be 60 for males and 55 for females and everybody has to pay the social security tax until retires. The civil servants and the employees of private sector would have the same 'Social Security System'.

The governmental companies such as Eti Ltd., State Tobacco Monopoly, State Alcohol Monopoly, Cyprus Fruits and Vegetable Exports Ltd, Dairy Industries, should be closed down or privatized.

### **4.3 Sectoral Strategies**

In this section general strategies for each sector are given.

#### **4.3.1 Finance**

The competition power of banking system and the power of the individual banks are very important in the integration progress. Therefore the first step is to examine the competition power of the banking system of the Turkish Component State of Cyprus (TRNC) compared to the Greek Component State of Cyprus and the EU banking system.

TRNC had banking and finance sector crises and also economic recessions and crises several times. Therefore the strength of the banking system has been decreased.

On the other hand, the banking system of South Cyprus is very strong. By applying necessary special programs the strength of the banking system of the Turkish Component State of Cyprus has to be increased. First of all the death credits of the banks and the credits given to the shareholders and the sister companies have to be examined and eliminated. The capital of the banks has to be increased. Therefore the marriage of the domestic banks has to be promoted. Also joint ventures with foreign banks have to be promoted.

There will be a single Central Bank of the common state and two branches of this central bank in each component states. The relationships of these central banks have to be well defined and a common policy has to be applied. The governors of the Central Bank have to be isolated from politicians of both sides.

There are many credit co-operatives in TRNC. Some of them are operating as banks and their financial positions are quite strong. On the other hand some small credit co-operatives are very weak and some of them need liquidation. The co-operatives have to be reorganized and those are operating, as a bank has to pass under the banking law and operate as a bank not as a co-operative. The small and weak co-operatives has to be joint together and has to operate as credit co-operatives and give loans only to their members not to the public. That which needs liquidation has to be closed before the integration progress of North and South Cyprus.

The financial strength of the Development Bank has to be increased. New capital has to be injected from the development budget. The outstanding credits have to be examined and those possible has to be recalled. Taking into account the new market dynamics of the iterative integrations a new credit policy has to be adopted by the Development Board. The new support programs for each sectors taking into account the dynamic advantages of new market conditions has to be prepared. The projects, which will be supported by the government, have to be authorized by the Development Board and the Development Bank has to support these projects.



#### 4.3.2 Industry

Industrial policy is the defend of the domestic production and the supports of the industries which has dynamic strategic advantages. Therefore, the industrial policy needs to analyze the changes both in the domestic market and the export markets. The industrial policy also needs to arrange new economic strategies according to the new market conditions.

The international world markets never become an ideal arena in which the market powers have free competition. Although the Turkish Component State of Cyprus will be a service production and exports center, certain needs of these service sectors has to be covered by domestic industrial production Therefore the Turkish Component State of Cyprus must have separate industrial policy.

There is a relation between industrial policies and the trade strategies. Therefore there must be a co-ordination between the foreign trade policies and the industrial policies. The main factor upon which the policies have to be built on is the dynamic comparative advantages of the component states of Cyprus.

The comparative advantages of each separate industrial production of TRNC has to be examined according to the future integrated market. This study has to take into consideration the opportunities of the 'Customs Union' with Turkey. Also this study has to take into account the opportunities and threads of large integration with EU.

Importing raw materials from Turkey and making production for common domestic market and even for the large European Market may have some advantages in some sub sectors of the industry. Also, some industries may have some advantages in importing raw materials from Europe and making production for the huge Turkish Market using the benefits of customs unions. Taking the advantages of the textile sector of Turkey some garment production sub sectors may have comparative advantage to import raw materials from Turkey and make production for common integrated domestic market and for the European Market. Also if it would be possible to enter in the production chain of some multinational companies in any sub sector and make production for Turkey may have some comparative advantage.

The industrial production of TRNC has to be reshaped according to the results of the comparative advantage studies in the new integrated market conditions. Those advantageous industrial productions have to be supported and others have to be dropped. For the industrialists who lost their advantages in the new market, special programs have to be applied to transfer them to new businesses.

#### **4.3.3 Trade**

Trade policy is one of the main tools of increasing the gross production of any country. Therefore a rational trade policy, which considers domestic strengths and weaknesses while taking into account the dynamic changes in the world market and the comparative advantages of the country, is essential.

Trade will be one of the advantageous sectors because of the enlargement of the domestic market through iterative integrations of North Cyprus Market. Also some costs related with the transportation and other embargoes will be removed after the settlement.

Today's trade sector of TRNC is based on import and distribution of goods in the domestic market of TRNC. The imports are mainly from Turkey. Before integration of the North and South Cyprus domestic markets, all the bureaucratic problems between the Turkish Component State of Cyprus and Turkey related with the Customs Union have to be settled. There must be no barriers against the free movement of goods services and capital between Turkish Component State of Cyprus and Turkey before the domestic market integration of Cyprus takes place. The importers of TRNC have to be promoted to make joint ventures with the Turkish firms for importing products of Turkey and distribute to the integrated domestic market of Cyprus. The bureaucracy has to be minimized and the importers have to enjoy the economies of scale of the new integrated domestic market.

The competition power of the trade companies of the Turkish Component State of Cyprus has to be increased by studying the weaknesses of each sub sectors. Efficiency and effectiveness of the companies will be an important factor. The



efficiency of the companies of TRNC has to be studied together with the Turkish Component State Government and the sub sector representatives, for each sub sectors separately. Efficiency courses have to be organized and given to the private companies. There will be very big competition between the Turkish importers and the Greek importers to get a big portion from the integrated domestic market.

Transit trade will be one of the promising trades after Cyprus takes place in the EU. Organizing direct exports from Turkey or becoming a buying agent of any European Company for Turkey will be a promising trade version. Also if the Common Government success to make Cyprus the trade gate of EU in the Middle East then the transit trade will become promising. Therefore double taxation problems between Turkey and Turkish Component State of Cyprus has to be avoided. Also Cyprus has to become a junction port of the international maritime lines and airlines.

Another promising trading version after the integration of North and South Cyprus markets will be selling souvenirs and gifts directly to the tourists. There is no doubt that tourism will be the basic leading sector of Turkish Component State of North Cyprus. The tourism sector is the basic leading sector of South Cyprus today and the sector will continue leading in the integrated common market of Cyprus. Therefore one of the aims of the trade sector of the Turkish Component State of North Cyprus will be to get maximum benefit from the tourists who will visit Cyprus.

#### **4.3.4 Tourism**

Tourism industry is the basic leading sector of South Cyprus. South Cyprus receives tourists about five times of their population. The climate conditions, the natural and historical properties and the distance to the main markets of North Cyprus are the same with South Cyprus. The main barriers against the tourism industry of TRNC are the embargoes, the isolations and the high transportation costs related with the unsettled Cyprus problem. These extra costs will be removed automatically after the non-recognition of Cyprus. Therefore tourism will be the leading sector of the Turkish Component State of Cyprus.

The competition power of the hotel owners has to be increased. In order to increase the competition power of the hotel owners, the financial situation of each hotel

owner has to be examined. The short-term loans have to be postponed to a large range of time. The facilities of the hotels have to be examined and have to be arranged to meet the new market demand. The efficiencies and the skills of the personnel have to be upgraded. Long-term loans have to be arranged for hotel owners for repairing, enlarging and completing touristic investments. The property problems of all the hotels and the places, which are suitable for touristic investments, have to be solved immediately after the settlement of the Cyprus problem.

The civil service organizations related with tourism in the both component states of Cyprus has to be the same, and has to work in harmony with each other. 'The Tourism Development Office' has to be established in the Turkish Component State of Cyprus. This office will be responsible for the development of tourism sector in the Turkish Component State of Cyprus. The members of the board of the Tourism Development Office will be; the economy and tourism ministry, ministry of public works and transport, the representative from the Development Board of Prime Ministry, representatives from Hotel Owners Association (two representatives), representatives from Tour Operators Association (two representatives) and the airlines companies. (If the airline companies registered in the Turkish Component State of Cyprus and operating in Cyprus are more than three then the companies has to make a sector association and sent two representatives to the office board) The office has to make all kinds of research and development strategies of the tourism sector of the Turkish Component State of Cyprus.

Special marketing and promotion strategies to advertise the Northern Cyprus in the main markets of the South Cyprus have to be prepared and applied by the Tourism Development Office. Special packet programs for one week or two weeks period has to be prepared and to be put in the main markets. Also the daily tours to the North Cyprus for the tourists visiting South Cyprus has to be prepared. The tourism season has to be enlarged to cover all the year by promoting conference tourism and also promoting the retired tourist to visit North Cyprus in off-season. Also by lengthening the staying period of the retired tourists in the North Cyprus. Also it is advised to sell houses to the retired persons from EU. Another important touristic product of the Turkish Component



State of Cyprus may be the special villages for the retired people of EU the and 'Health Tourism'

The cost factors of the Northern Cyprus tourism sector has to be studied related with the new integrated market dynamics. It seems that the labor costs of the sector will be increased while the foods and beverages costs will be decreased. The Turkish Component State has to arrange electricity, transport and communication prices not to be higher then the Greek Component State of Cyprus. If necessary Turkish Component State Government has to subsidize these cost factors from the development budget.

The efficiency and the quality of the service supplied to the tourists will be another important factor in the success of the sector. The tourism development office has to arrange special award system and also a complaining and controlling system for the efficiency and the satisfaction of the tourist. The Tourism Development Office and the universities have to arrange short-term skills upgrading programs for the personnel of the tourism sector.

#### **4.3.5 Agriculture**

Agriculture is a very important sector for every country because it minimises unemployment. The climate conditions are very important in agriculture. Cyprus has a very fluctuating climate conditions related with rains. Usually many years, rains are not enough and Cyprus has scarcity of water.

The project of construction of pipelines under the sea and bringing water from Turkey has to be put in the settlement agreement of the Cyprus Problem and the financial resources of the project has to be well defined.

The 'Agriculture Development Office' has to be established under the joint management of the Ministry of Agriculture, Ministry of Economy and Tourism, SPO, universities, and also representatives from agricultural sub sectors (farmers, live stock farmers, fruits and vegetables farmers). This office has to make studies to find and adopt suitable products and production techniques for the agriculture of the Turkish Constituent State of Cyprus.

The agricultural areas, which will be left under the control of the Turkish Component State of Cyprus, will have no ownership problem after the settlement agreement of Cyprus Problem is signed. Then the rehabilitation of the farmers and agricultural areas according to the new conditions of Cyprus has to be finished as soon as possible. Special long term loan systems and other promotion systems has to be arranged and applied in order to re-energize the agricultural production by the Development Board through Development Bank.

The legal structure and the operation of the sector have to be harmonized with the Common Agricultural Policy of EU. An EU unit in the ministry of agriculture has to be established in the ministry of agriculture and the harmonization process of the sector with the Common Agricultural Policy has to be directed by this unit.

The agricultural production units have to be classified into two categories. The first category would be the big agricultural farms where the modern production techniques and the economies of scale are applicable. The second category would be the small agricultural production units, which would be the small family production units where a second income for the family is obtained. The first category of the agricultural production has to be promoted according the CAP of EU. For the second category of agricultural production, special long term loans and marketing programs has to be developed by the 'Agricultural Development Office'. These programs may be, order based production of agricultural products, bio-agricultural production, out of season vegetables production greenhouse production.

#### **4.3.6 Service Sector**

The importance of the service production for export markets in today's global world is gradually increasing. TRNC had a satisfactory improvement in the exports of services. The main service exports is university education to the students from other countries. The students are coming mainly from Turkey, from Near East countries, from Pakistan and from Sudan. TRNC is a country of universities having five universities already offering education service to students from other countries.



After the settlement of the Cyprus problem and entering to EU, these universities will continue to give higher education service. There will be an increase in demand from non-European countries, namely Near East countries, Pakistan, and other Asian and African countries and also from Turkey. On the other hand the Cypriot students will have the chance to attend other universities of Europe as a European student. Therefore the number of the Cypriot students in these universities may decrease

The government of the Turkish Component State of Cyprus and the universities has to establish a joint upgrading program of service production taking into account the new market conditions. The social and cultural facilities and also the technical facilities of the universities have to be increased. The universities have to be enlarged. For these purposes a special long-term loan system only for the universities has to be adopted by the Development Bank. The number of universities should not to be increased. Also the competition between universities has to be controlled by the 'Development Board' not to harm the service exports.

The universities have advantages to export other services then education. Some of these services are; software development, information technology services, legal services, business support services, consulting, research and physibility study services, preparing technical projects.

The 'Service Development and Exports Division' has to be established under the Development Board. In this division there will be representatives from each universities, from the ministry of economy and tourism and from the ministry of education. The main of this division would be to develop new service products for export markets. Promoting private sector to enter service production for exports. Giving intensives to the service producers to penetrate into export markets. Also to increase the skills of the university graduates towards production of these kinds of services.

Another important service product for exports is medical services. There are many people in Turkey who goes to the other counties for medical services. Also hospitals of Turkey are over-crowded. The initial investments for the building and

instruments of high quality hospital are too big relative to the capital concentration of Northern Cyprus private sector. The Turkish Component State of Cyprus has to promote joint ventures and FDIs to the medical service sub sector. Another way to overcome the initial investment barrier of this sub sector, the Turkish Component State of Cyprus has to apply the 'Cheabol' model of South Korea and has to promote three or four companies for medical service exports.

The co-ordination of service exports and tourism is very important. Another advantage of the service exports is the increase in the number of visitors of the Turkish Component State of Cyprus, which will be helpful to energize other sectors in the domestic market of Northern Cyprus.

#### **4.3.7 Construction**

After the settlement a strong boom in the island-wide construction sector is expected. There are certain reasons to expect this booming in the construction sector. First of all there will be significant effective demand for construction of houses because of the property arrangements within the settlement. Secondly the restoration projects for Varosha and Nicosia will be undertaken. A large scale of infrastructure development projects will be implemented. These projects will include building and improving major highways, upgrading and expanding electric energy systems and telecommunication systems, ports and airports developments. Thirdly the strong booming in the tourism sector will lead increase in demand for expanded facilities. Therefore construction in tourism sector will grow rapidly.

The competition power of the Turkish Component State of Cyprus construction sector and the individual firms has to be examined and upgraded by the Development Board. The sector has to aim to obtain the maximum portion from the booming market. For the large-scale constructions the Turkish Cypriot construction companies has to make strategic joint ventures with the Turkish construction companies. The joint ventures in the construction sector have to be promoted by the Development Board. After increasing their experience in large scale construction in the island, these joint ventures has to be promoted to make constructions in other countries and increase the volume of the service exports of Turkish Component State of Cyprus.



Construction activities are highly labor intensive activities. The skills of unemployed of the Turkish Component State of Cyprus have to be directed and increased for working in the construction sector. Special technical education programs have to be arranged for this purpose by the Development Board. The low-wage unskilled labor demand for the construction sector could be supplied from Turkey.

#### **4.3.8 Transport and Communication**

Cyprus has comparative advantages of location in the post settlement world, which would play a steadily growing role of Cyprus in the regional economic activities of the Eastern Mediterranean. In addition to its service-oriented economy, Cyprus might enable to develop a regional air transportation and maritime service center. Further, Cyprus could use its EU membership to become a commercial opening gate of the EU to the Middle East and the Eastern Mediterranean.

The post settlement Cyprus as a service –oriented economy must have a first class high technology, transport and communication infrastructure. Therefore the communication network of the Turkish Component State of Cyprus has to be upgraded. There must be at least one international airport under the control of Turkish Component State of Cyprus. This airport has to be equipped with the latest technology and facilities

Famagusta Port has to be renovated, upgraded and enlarged in order to become a commercial gate of the EU in the Eastern Mediterranean Sea. Special incentives to the foreign maritime line companies has to be given by the Turkish component State of Cyprus so that the maritime lines will connect their international lines at Famagusta Port.

Foreing direct investments and joint ventures in airlines and shipping sectors in the Turkish Component State of Cyprus have to be promoted by the Development Board. Also companies in the airline sector have to be established and promoted like 'Cheabols' of South Korea. The Turkish Component State of Cyprus would be most easily accessed place of the Eastern Mediterranean region. Also where the best and relatively cheap transportation and communication service could be obtained.

#### 4.4 EU Membership

EU membership offers very significant long-term economic benefits to Cyprus, through the opportunities it would provide to participate in the integrated European market for goods and services and investment flows.

EU membership of Cyprus would require adoption to the 'acquis communautaire' in the Turkish Component State of Cyprus. This has many positive implications. The pre-existing institutions, laws and regulations associated with EU accession would provide detailed guidelines to organize basic market-oriented economic relationships. For the Turkish Cypriot side the task of liberalizing and reforming economic institutions and activities has not yet begun. Restructuring and adjustment in anticipation of EU accession would be the first major theme of economic policy-making across all sectors of the economy in the North, in the period immediately following a settlement.

EU membership would mean access to the significant capital resources for the Turkish Component State of Cyprus. First the EU would make available resources focused on pre-accession assistance. Funding would become available to offset the expenditure involved in adopting the 'acquis communautaire' as the Turkish Component State's economy strives to conform to standards. Further the Turkish Component State of Cyprus would also receive pre-accession grants and loans aimed at helping integrate its economy into the EU, plus some capital financing from the European Investment Bank, designed to assist enterprises in preparing for competition in EU markets as a result of Accession. Additionally, with EU accession the Turkish Component State of Cyprus would also benefit from financial aid, particularly in the form of capital grants from the EU's Regional Development Fund. This facility is targeted at the relative poorer regions within EU member countries and aims to raise living standards in such regions to 75 percent of the EU average. Based on current level of GDP per capita the Turkish Component State of Cyprus would qualify this support.

Immediate after the settlement, the Turkish Component State of Cyprus will start to use Cyprus Pound, which is already pegged to Euro. The Maastricht Criteria will be achieved and Cyprus will pass to Euro. The Maastricht criteria provides an externality in the discipline and the stability of public finance. This will give a powerful financial



structure and high performance to the Turkish Component State of Cyprus. This will give the chance to the Turkish Component State to make effective planning and budgeting and systematic control.

The competitive market of EU will give pressure to the firms of the Turkish Component State of Cyprus to increase their productivity and efficiency. The integration of Cyprus economy to EU markets will attract FDI's to Cyprus. The Turkish Component State of Cyprus has to organize so that to get the biggest portions from these investments.

#### 4.5 Revision of the Development Strategy

The meeting of the leaders of two communities with the UN Secretary General Mr. Kofi Annan at 10th March 2003 in Lahey was not successful. The intercommunal talks collapsed. Therefore, the paragraphs 10 and 11 of the resolution of European Council in Copenhagen at 12-13 December 2002 were failed<sup>147</sup>. The paragraph 12 which was related with the absence of solution is as follows.

“The European Council has decided that, in the absence of a settlement, the application of the *acquis* to the northern part of island shall be suspended, until the Council decides unanimously otherwise, the Council invites the commission, in consultation with the government of Cyprus, to consider ways of promoting economic development of northern part of Cyprus and bringing it closer to the union.”<sup>148</sup>

The main assumptions of the introduced strategy are collapsed. The settlement of Cyprus problem according to the UN Secretary General proposals was not achieved. Therefore the Turkish Component State of Cyprus was not established. On the other hand the assessment calendar of Cyprus to EU is continuing and according to this calendar the south Cyprus government will sign the assessment treaty of Cyprus with EU as ‘Republic of Cyprus’ at 16th April 2003 in Selanik.

<sup>147</sup> <http://www.ec-eu-delegation.com.cy/en/news/COENHGN%20Conclusions.html>

<sup>148</sup> *Ibid.*

On the other hand it is obvious that in some way of the other the negotiations for the settlement of the Cyprus problem will start again. Meanwhile the assessment of south Cyprus to EU with the name of 'Republic of Cyprus' and as a representative of whole Cyprus will be achieved.

The introduced strategy has to be revised about the new political situation and above assumption. Further according to the ongoing political process it is assumed that following conditions will be happened.

- 1- Cyprus will become a member of EU. South Cyprus government will represent Cyprus with the name of 'Republic of Cyprus' in EU.
- 2- Northern Cyprus will also be in EU. The governing authority of Northern Cyprus TRNC will not be recognized by EU.
- 3- The application of the acquits to Northern Cyprus will be suspended until the settlement of the Cyprus problem.
- 4- South Cyprus government and EU will consider ways of promoting economic development of northern part of Cyprus and bringing it closer to the Union, without recognition of TRNC.
- 5- The pre-accession process of Turkey to EU will continue onwards and the assessment negotiations between Turkey and EU will start earliest at 2005.

Assuming the above conditions will take place, the following revisions in the introduced strategy has to take place.

#### **4.5.1. Revision of the Restructuring of Civil Services**

Although the political settlement of Cyprus is not achieved, still the only possibility of Northern Cyprus after settlement is to access EU, because south Cyprus will be a member of EU with the name 'Republic of Cyprus'. Until settlement TRNC has two alternatives:

- 1- TRNC could close the borders of north and south Cyprus and not accept any promotion for economic development from EU through 'Republic of Cyprus'.



- 2- TRNC could arrange Northern Cyprus according to the new structural changes in Cyprus. In other words TRNC could arrange Northern Cyprus according to the assessment of Cyprus to EU.

While the embargoes are ongoing, further closing Northern Cyprus to outside world is not a clever choice. The non-recognition and closing the borders together may create social problems in Northern Cyprus. Also refusing to use the benefits of membership of Cyprus to EU is not a right choice. Therefore the revision of the strategy is made according to the above second alternative

The offered economic organization of the Turkish Component State of Cyprus (Fig. 4.2) has to be applied to TRNC. The Deputy Prime Ministry, responsible from the relations with EU, has to be established. Simply the names 'Turkish Component State of Cyprus' has to be changed as TRNC in the strategy. The other changes are listed below:

- 1- The currency in the circulation in TRNC has to be changed from TL to Euro. Since, after the settlement, the economic integration of North Cyprus will be South Cyprus and EU, then no need to stay and wait in TL. Turkish economy is still instable and the inflation in TL creates many problems in the development of Northern Cyprus, as it is explained in Chapter I. Therefore passing to Euro will avoid these problems.
- 2- The incomes of 'Price Stability Fund' have to be added to the revenue side of the 'Development Budget'. The Deputy Prime Ministry has to arrange technical and bureaucratic contacts with the Commission and obtain aids from EU for the economic development of Northern Cyprus according to the paragraph 12 of Copenhagen resolution.<sup>149</sup> These aids will be added to the revenue side of the 'Development Budget'.
- 3- The Deputy Prime Ministry has to start the convergence process of Northern Cyprus to Copenhagen and Maastrich criterias. Also the Deputy Prime Ministry has to start the pre-accession process of Northern Cyprus to EU, that is the harmonization of Northern Cyprus laws and regulations to EU.

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<sup>149</sup> Ibid.

- 4- TRNC has to open the North and South Cyprus border from the north. The free movement of humans, goods and services has to be promoted in both directions.
- 5- TRNC has to accept the dual nationality for the citizens. Then, the citizens of TRNC could obtain European identity through the nationality of 'Republic of Cyprus' together with the identity of TRNC.
- 6- All the tariffs and off-tariffs barriers against the free movement of the goods between TRNC and Turkey have to be abandoned.
- 7- The macroeconomic policies has to be arranged so that the products of TRNC and the imported goods from Turkey would be advantageous in the markets of both parts of Cyprus
- 8- The custom charges on the imported goods to TRNC from other countries then Turkey has to be same as the south Cyprus

#### **4.5.2. Revisions in the Sectoral strategies**

The same sectoral strategy has to be applied to the finance sector except the Central Bank of TRNC has to operate independent from the Central Bank of 'Republic of Cyprus'.

The industrial and trade policy of TRNC will be the same as in the introduced strategy except the sales of the domestic products of TRNC and imported goods from Turkey to south Cyprus has to be promoted

No change in the tourism strategy but subsidies to the tourist tickets. Incentives to the daily visits of Northern Cyprus by the incoming tourists of south Cyprus.

No change in the sectoral strategies of agriculture and service sectors. The expected booming in the construction sector will not take place. The transportation and communication services of TRNC have to be cheaper than south Cyprus while at least at the same level of quality.



#### 4.6. Conclusion

The aim of this thesis is to prepare 'A Development Strategy to Northern Cyprus'. The economic development is the aim of all countries in the world but only a few countries succeed to develop. Many economists are working to find an answer to the question why some countries are developing while the other countries are remaining underdeveloped? There is not a unique answer for this question. In today's world, it seems that, those countries, which succeed to maximize their competition, power and used their comparative advantages in the world market, and applied clever development strategies are managed to develop.

In chapter three of this thesis the experiments of some countries, which are developed in the second half of the twentieth century, has been examined. The common factors in order to increase the competition power of a country are found as follows.

- 1- The basic human rights have to be provided and guaranteed by the legal system. Also the legal background of a competitive market in which individuals and the firms would compete freely has to be established and guaranteed.
- 2- The bureaucrats and economic technocrats have to be isolated from the pressure of the politicians. Also the ideologies of the elites have to be accommodated with the economic development policies. The elites not to poison the politics.
- 3- The fruits of economic prosperity have to be shared not only among the economic world but also the whole society.
- 4- The skills and the education level of human resources have to increase according to the necessities of the economic development.
- 5- The development and stability has to be balanced by very clever macroeconomic policies. Also balanced budgetary policy has to be applied.
- 6- Dynamic planning and clever government interventions are the main tools of economic development. But the costs of government interventions have to be controlled within certain limits and the future benefits of the interventions have to be measured to be greater than the costs.

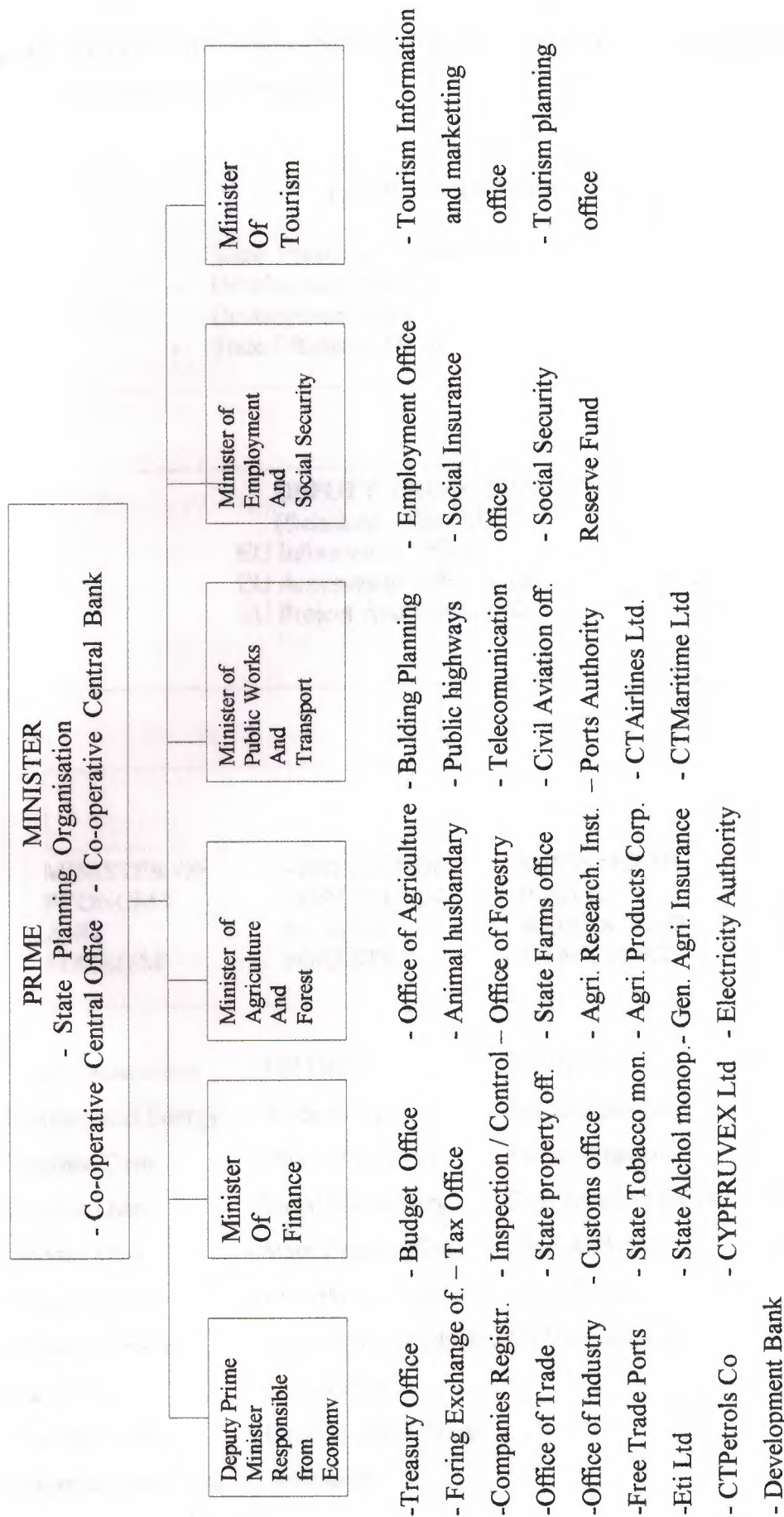
The introduced development strategy for Northern Cyprus in chapter four considers the above common factors to increase the competition power of TRNC. The structural and dynamic changes in the exports market as well as domestic market has to be considered. The comparative advantages have to be used by taking into account these changes.

The politic and economic structure of today's World is changing very quickly. Therefore the development strategies have to be re-arranged according to the new changes in the structure of the market. The 'Republic of Cyprus' adopted her development strategy very successfully according to the changes in the political structure of Cyprus after the Turkish Peace Operation in 1974.

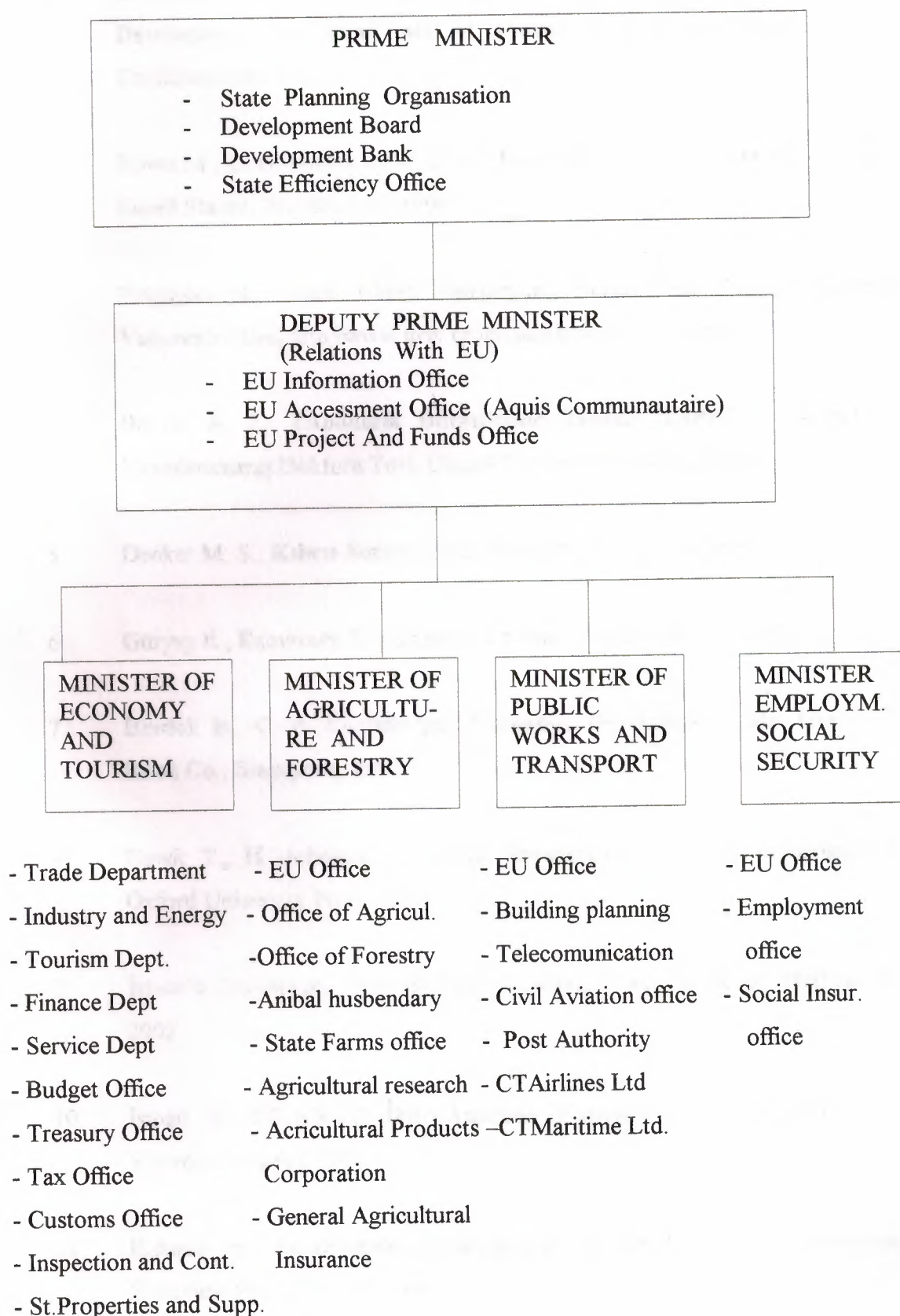
The introduced strategy in Chapter IV is a dynamic strategy and changeable according to the political changes in Northern Cyprus. As it is seen in section 4.5 the strategy is revised because of the collapse of the settlement according to the Annan Plan.



Fig 4.1 ECONOMIC ORGANISATION OF TRNC



**Fig. 4.2 ECONOMIC ORGANISATION OF THE TURKISH COMPONENT  
STATE OF CYPRUS**





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