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GLOBALIZATION AND BANKING SECTOR: CASE OF TRNC

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ABSTRACT

Globalization can be seen as an evolution which is systematically restructuring interactive phases among nations by breaking down barriers in the areas of culture, commerce, communication and several other fields of endeavour.

One of the most important results of globalization has been the integration of banking activities across international boundaries.

The purpose of this study is to evaluate the impact of globalization on the banking sector of Turkish Republic of Northern Cyprus (TRNC). In regards to this, at first, the impact of globalization on banking sector, in general meaning, is specified; then the economy of TRNC, current position and importance of the banking sector, basic problems of the banking sector, the extent of globalization in the banking sector and, additionally, possible impacts of globalization on the TRNC banking sector in the light of European Union (EU) membership are assessed, and conclusion and recommendations are provided at the end of the study.

It will be seen that the level of globalization in the banking sector of TRNC is minimal. The sector's international activities are very limited, as it is not possible for the banking sector to establish cross-border mergers, to provide a guarantor role for other countries except Turkey, and to be a member of international networks like SWIFT.

The extent of globalization in the TRNC banking sector can be seen from the following: integration of the TRNC international banking services to other countries' financial systems through correspondent banking; ability of the local banks to provide transfers to any country and accept transfers from any country; subsidiaries of Turkish Bank Ltd. in foreign countries; no restrictions on capital inflows and capital outflows in regard to foreign countries; 21 offshore banks in TRNC.

Considering future opportunities for the Turkish-Cypriot banking sector to participate in globalization in full array and benefit from yields of this trend, the possible EU membership of TRNC is an appropriate alternative for this. This membership will bring a lot of changes, challenges and opportunities for the TRNC banking sector. On the one hand, the local banks will be able to provide full range of international banking activities. On the other hand, the sector will be faced with increased competition. So, current problems of the banking sector should be solved and necessary preparations should be made in order to create a strong banking sector competitive enough, to be able to cope with a new market environment conditions and share the benefits of globalization in the light of EU membership.

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1. INTRODUCTION

Banking sector is one of the main sectors of any country's economy. The sector is important in accumulating savings, channeling them to investments and contributing to the economic development of a country (Bıçak & Menteşoğlu 1999, p. 527).

There are several trends affecting banking. One of them is globalization. The consequences of banking globalization are increased market size, increased competition and benefits such as economies of scale and scope, attracting foreign direct investment (www.stern.nyu.edu/~pwachtel/CaracasPresentation.pdf), and additionally, as in an interview I conducted on 19 July 2004, Mr. T. Ekdal said about establishing cross-border mergers, ability to become a member of international institutions like the Bank for International Settlements and foreign global networks like SWIFT. There are customers engaged in international business and seeking for global banking service needs. So, the globalization is very important for banking sector in order to meet customers' global financial service needs and to have access to the benefits.

In this study, we aim to figure out the impact of globalization on the TRNC banking sector.

The paper is laid out as follows. In Section Two, in general meaning, the concepts of globalization and banking sector, impact of globalization on banking sector, advantages and disadvantages of globalization of banking sector, the roles of international supervisory institutions in globalization trend are discussed. Section

Three explains the economy of TRNC, current position and importance of the banking sector, basic problems of the banking sector, the extent of globalization in the banking sector, and possible impacts of globalization on the TRNC banking sector in the light of EU membership. Section Four provides conclusion and recommendations.

2. GLOBALIZATION AND BANKING SECTOR

2.1 The Concept of Globalization

Globalization is not a new phenomenon. Capitalism has been of a global character since the time Europeans began setting up colonies in the 1400s. Colonial economies were organized to suit the needs of the core countries of the capitalist world system. Although the principles of globalization have been around for the "long durée," there are nonetheless several elements of globalization that are widely accepted as representing the current phase of global capitalist development. The increasing interconnectedness of markets, finances, goods and services, and the growing stature of transnational corporate networks heavily influence the economic, political, and cultural processes of globalization today. It is noted that this influence involves creating a new world market, new transnational political organizations and a new global culture. This process of globalization is not linear, but rather involves a dialectical relationship between its economic, political, and cultural dimensions that often appear contradictory and chaotic.

2.1.1 Economics

The economics of globalization represents the contemporary process of capitalist accumulation. This process is manifest through global commodity chains and a global division of labor, the global mobility of capital, the increasing concentration of industries into a small number of transnational corporations, the development of global regulatory institutions, and a shift in world trade from goods and services to financial instruments. At the center of this process are international elites who have been able to bring the world economy under the domain of multinational corporations without losing the national economic priorities of the leading core states. Although the relationship between governments in the core states and elements of the international elite (the majority of the latter are citizens of core states) has been mainly harmonious, at times it is prone to tension and overt disagreement.

Economic globalization can be demonstrated empirically by looking at the increasing percentage of world trade as a percentage of world production. The Human Development Report (HDR) notes this increase in international trade: "world exports, now $7 trillion, average 21 percent of GDP in the 1990s compared to 17 percent of a much smaller GDP in the 1970s". This growth in international trade is necessarily accompanied by increasing transnational linkages in production, which is further facilitated by technological improvements undertaken by transnational corporations in core capitalist states. Economic globalization has accelerated because of the post 1960s "electronics revolution," which "transformed the quantitative possibilities of transferring cash and money capital into qualitatively new forms of corporate and personal financing, entrepreneurship, and, crucially, the system of credit on which the global culture and ideology of consumerism largely rests". In 1980 average daily foreign exchange trading totaled $80 billion, "today it is estimated that more than $1,500 billion changes hands daily on the global currency markets".

2.1.2 Politics

The politics of globalization is represented by the emergence of global governance and the increasing contradictions between and within nation states. The central political tension of globalization rests between increasingly powerful transnational institutions (like the World Trade Organization, United Nations, World Bank, International Monetary Fund, as well as multinational corporations) and sovereign nation-states over the regulatory landscape of global capitalism. Globalization involves a shift in organization from a nation-state level to intra-regional and transcontinental levels of political organization. This means that the relationships between nation-states are increasingly mediated through institutions of global governance. Areas of national sovereignty are being redefined, in part because global financial markets require global governance to insure reliability and security. Even so, the control over global finance remains firmly embedded within the core financial capitals of Tokyo, London, New York, Frankfurt, and Paris. Core countries have a disproportionate amount of control over the institutions of global governance and thus are expanding their control over the global capitalist process despite the threats to their own sovereignty. Consequently, this tension affects political processes within nation-states as groups jockey to favorably influence state action within the context of global governance. This process is evident in bioagriculture, for example, where European and African nation-states are attempting to keep out genetically engineered grains produced by American agro-multinationals on the one hand, while the agro-multinationals based in the US are influencing their government's action to take their case to the WTO on the other.

2.1.3 Culture

The culture of globalization is about the increasingly interconnected social world, which both weakens the uniqueness of national ways of living, local cultures and non-capitalist values, but also encourages a convergence of communication and style among diverse people throughout the world. The process of cultural globalization preferred by the international elite is one that incorporates the world community as consumers of goods and services produced, developed, and distributed by transnational corporations – that is, consumerism of the western model is the dominant process of cultural globalization. Since the late 1970's, multinational corporations have been targeting distinct social groupings via ethnicity, gender, class, race, and sexual orientation in order to satisfy consumer needs and wants through the production, promotion, and delivery of goods and services. This strategy of constantly dividing and sub-dividing the world is enhanced by "split-second" technology, that not only allows for the accumulation of detailed patterns of purchases by consumers, but also provides for the transmission of that knowledge in compact forms (like CD-ROMs) to any marketer with the money and the desire to buy such information. In this sense, global corporations have embraced multiculturalism in so far as it provides a vehicle to reduce active citizenship to patterns of consumption. That is, cultural differences are used to equate happiness and the realization of dreams to that of purchasing commodities. At the core of this ideology of consumerism is individualism; however, the internalization of this force for cultural homogenization is experienced in culturally specific ways. Although powerful, the cultural process of globalization can be interpreted using local cultural lenses and thus provide opportunities for resistance (http://www.globalization.icaap.org/content/v3.2/02_ramsaran_price.html).

2.2 The Concept of Banking Sector

Banking sector is an economic subsector, which refers to financial institutions and banks that provide "producing and selling professional management of the public's funds as well as performing many other roles in the economy" (Rose 1993, pp. 6-7).

"The Many Different Roles Banks Play in the Economy:

The intermediaton role
Transforming savings received primarily from households into credit (loans) for business firms and others in order to make investments in new buildings, equipment, and other goods.

The payments role
Carrying out payments for goods and services on behalf of their customers (such as by issuing and clearing checks, wiring funds, providing a conduit for electronic payments, and dispensing currency and coin).

The guarantor role
Standing behind their customers to pay off customer debts when those customers are unable to pay (such as by issuing letters of credit).

The risk management role

Assisting customers in preparing financially for the risk of loss to property and persons.

The savings/investment advisor role

Aiding customers in fulfilling their long-range goals for a better life by building, managing, and protecting savings.

The safekeeping/certification of value role

Safeguarding a customer's valuables and appraising and certifying their true market value.

The agency role

Acting on behalf of customers to manage and protect their property or issue and redeem their securities (usually provided through the bank's trust department).

The policy role

Serving as a conduit for government policy in attempting to regulate the growth of the economy and pursue social goals" (Rose 2002, p. 9).

2.3 The Impact of Globalization on Banking Sector

Globalization effects banking and finance in two ways. First, banking and financial services are the vehicle for globalization of world economies generally. Banks globalize because they follow the activities of their customers. In addition, the availability of international banking services reduces the costs of globalization in other industries and encourages international diversification and makes international investments more attractive. Second, the banking industry itself is quickly becoming an internationalized industry. The recent moves towards globalization of the industry are astonishing since banking tends to be a tradition bound, older industry where local and governmental ties are very important.

International banking activity is not new but it has traditionally been restricted to bankers following their customers around the world. Prior to ten years ago, most foreign banking operations were efforts to service the foreign activities of domestic customers. However, a major new pattern of international banking activity emerged in the 1990s. Cross-border banking activity and bank ownership has mushroomed in just a few years.

Two developments in Europe provided an impetus for these changes. First, the transition in the formerly planned economies presented European bankers with what was perceived to be virgin territory in their own cultural milieu. Second, the Euro zone has reduced the foreign exchange risks that make cross-border activity costly and it has made bankers much bolder. This development was a long time coming. All legal barriers to cross-border banking within the EU disappeared in the early 1990s. However, there was very little effort to take advantage of the common market in financial services until monetary union appeared more certain. Only as the Euro currency zone became a reality, in 1998 and 1999, did cross-border bank mergers begin to occur (http://www.stern.nyu.edu/~pwachtel/CaracasPresentation.pdf).

Foreign banking activity in the transition economies and the changes induced by currency union in Europe has started to affect the rest of the world. Bankers have become much bolder and cross-border bank mergers and acquisitions have mushroomed in the last few years.

These trends have emerged from the belief that liberalization leads to greater profitability, more efficient allocation of resources and diversification of risk. Banks, like firms in other sectors of the economy, must compete with each other globally as part of a broader process of political and economic integration (http:// www.msu.edu/~bilesjam/tigfinal.pdf).

Additionally, it is essential to note that increased competition is one of the main consequences of globalization. The increased competition makes new demands on old established enterprises and they must either adapt or die (http://www.bis.org/review /r001024c.pdf). This stronger competition will lead up probably to eliminating less competitive banks and financial institutions from global market.

The table below shows foreign control of banking in selected emerging markets in Europe, Asia and Latin America. Foreign control of bank assets has increased rapidly in just the last 5 years. The situation in Venezuela where foreign control went from virtually zero in 1994 to over 40% in 1999 is not unusual. There are a few exceptions to the recent internationalization of banking such as Turkey and South Asia where there are still barriers to foreign entry. In many other countries, such as Brazil and Poland, there was substantial resistance to foreign bank entry that disappeared in the last few years (http://www.stern.nyu.edu/~pwachte1/Caracas Presentation.pdf).

Table 2.1 Foreign control of Banking in selected emerging markets

(% Of total bank assets in banks where foreigners own more than half of total equity)

	1994	1999
Czech Republic	6	49
Hungary	20	57
Poland	2	53
Turkey	3	2
Argentina	18	49
Brazil	8	17
Chile	16	54
Colombia	6	18
Mexico	1	19
Peru	7	33
Venezuela	0.3	42
Korea	1	4
Malaysia	7	12
Thailand	1	6

Source: (http://www.stern.nyu.edu/~pwachte1/CaracasPresentation.pdf)

2.4 Advantages and Disadvantages of Globalization of Banking Sector

The globalization of banking improves banking practice and creates growth oriented financial sectors. Besides the efficiencies that it brings through international financial service firms and the profits it brings to them, it is important because it changes the overall banking sector environment. To substantiate this argument, we will discuss what the entry of foreign banks can be expected to accomplish. We will also review some of the objections to foreign bank entry.

Potential contributions of foreign bank entry to emerging markets:

(i) Product and service innovation. Foreign banks are likely to be major sources of product and service innovation. New entrants and competitive pressures will reduce interest rate spreads, which will benefit both savers and borrowers. Similarly, new entrants will hasten the spread of good banking practices such as modern techniques for loan evaluation and efficient clearing operations.

(ii) Economies of scale and scope. Foreign banks often acquire existing institutions and help bring about consolidation that allows for economies of scale. Also, new entrants are likely to introduce new financial sector activities - insurance, portfolio management, brokerage activity - which allows banks to exploit economies of scope.

(iii) Develop financial markets. The entry of foreign banks will assist in the development of financial markets. For example, foreign banks that lack a branch network to generate deposit financing of their activities are likely to turn to the interbank market. Thus, foreign bank entry will develop the market and promote the market determination of interest rates. Another example is that the foreign banks may be able to attract banking business that might otherwise go abroad.

(iv) Attract foreign direct investment. Banks with international connections will facilitate the activities of foreign investors. Foreign bank entry often follows FDI because the foreign banks serve their home country customers in the foreign market. However, it is also the case that the existence of foreign banks in the market reduces the costs of entry to firms from abroad. Thus, the existence of foreign banks is likely to increase the volume of FDI (http://www.stern.nyu.edu/~pwachtel/Caracas Presentation.pdf).

"While globalization brought new opportunities and rewards, it also brought new risks. At roughly the same time that President George Bush proclaimed a "new world order," the process of consecutive disorders afflicted global finance. As Ethan B. Kapstein noted in the November 1998 issue of Current History: "Beginning with the exchange rate shocks that rocked Western Europe in 1992 and 1993, the world has experienced banking and currency crises in Mexico in 1994–95, East Asia in 1997–98, and Russia and Latin America in August 1998." Brazil was threatened again in early 1999 with a similar meltdown, indicating that the globalized market and free flow of capital carried the risk of contagion that was both rapid and deadly" (Hughes & MacDonald 2002, p. 30).

By the way we can evaluate "some of the risks confronting the international banker:

- **Credit risk,** the danger that a borrower defaults on a debt obligation.
- **Liquidity and funding risk,** the threat of insufficient liquidity on the part of the bank for normal operating requirements.
- **Settlement/payment risk,** which is created when one party of a deal pays money or delivers assets before receiving its own cash or assets, hence exposing itself to a potential loss and interest rate risk.
- **Interest rate risk,** the risk that arises from mismatches in both the volume and maturity of interest-sensitive assets, liabilities, and off–balance sheet items.
- **Market or price risk,** the exposure of banks to losses due to market or price fluctuations in well-defined markets.

- **Foreign exchange or currency risk,** the exposure of banks to fluctuations in foreign exchange rates that affect positions held in a particular currency for a customer or the bank.
- **Sovereign risk,** in which the political or economic conditions in a particular country threaten to interrupt repayment of loans or other debt obligations.
- **Operating risk,** arising from losses caused by fraud, failure of internal control, or unexpected expenses, as in the case of lawsuits" (Hughes & MacDonald 2002, pp. 6-7).

There is problem of product differentiation in international retail banking:

"Unlike in corporate and investment banking, retail banking products, customs, and regulations differ greatly from country to country. New entrants often face an uphill battle against established local players with large branch networks.

Testifying to the difficulty of international expansion in retail banking, several banks have tried and failed in this process since the 1980s.

Internet banking is not risk-free. One problem is the ease of Internet banking scams. Additionally, there is possibility of the proliferation of businesses posing as banks on the Internet. These companies are not banks, as they are not legally chartered by state or federal governments, and their deposits are not insured, but consumers are not always aware of these subtleties. Thus these operations may be easily confused with legitimate banks doing business on the Internet, posing a threat to consumers and legitimate banks alike.

Moreover, the technological requirements of Internet banking require large up-front investments, which may not pay off immediately. As a result of high start-up costs and intense competition, only a few direct banks are profitable so far. At the same time, competition from Internet upstarts is threatening traditional banks" (Hughes & MacDonald 2002, pp. 165-9).

"Another problem area related to globalization is the spread of financial fraud, in particular, **money laundering**. The more rapid the ability to transmit and receive money and credit, the more difficult it is for regulatory and law enforcement agencies to deal with the illicit flow of funds and practices. Every day, international criminal organizations seek to launder their ill-gotten profits through a number of offshore financial centers, while seeking new means to facilitate the washing of dirty money into clean and more investable legal tender and assets"(Hughes & MacDonald 2002, p. 8).

2.5 The Roles of International Supervisory Institutions in Globalization

The need of international regulatory cooperation and response to some negative effects of globalization led to creation of several international institutions such as the Basel Committee on Banking Supervision, the Bank for International Settlements (BIS) and the International Monetary Fund (IMF).

2.5.1 The Basel Committee

"The Basel Committee is one of the most significant organizations dealing with international bank supervisory issues. Its secretariat is provided by the BIS, and each member government sends representatives. The Basel Committee's work covers three major areas:

- It is a forum for discussion on the handling of specific supervisory problems.
- It coordinates the sharing of supervisory responsibilities among national authorities in respect of banks' foreign establishments. The goal of this is to ensure effective supervision of banks' activities worldwide.
- The Basel Committee seeks to enhance standards of supervision among its members" (Hughes & MacDonald 2002, p. 262).

For example, "in 1988, many observers heralded the Basle Agreement as a first step toward truly worldwide coordination of banking regulations and toward integration of world banking markets" (Miller & VanHoose 1993, p. 781).

2.5.2 The BIS

The Bank for International Settlements acts "as an agent or trustee for international loan agreements and manages portions of the reserve accounts of some central banks, which it places in world financial markets. That is, some central banks hold deposits at the BIS, which it uses to purchase securities. The BIS also lends to some central banks.

A key function of the BIS is that it is a clearing house for information for central banks around the world; that is, it is a center of international cooperation in both banking and monetary affairs. Staff members of the BIS organize periodic meetings of experts to brief central bankers on financial and monetary conditions and conferences for central bank staff economists and regulators from participating nations" (Miller & VanHoose 1993, p. 781).

2.5.3 The IMF

"One of the most important institutions providing support for international cooperation in better banking is the IMF. The IMF maintains various training programs, sends teams of experts to help governments formulate and implement improved regulatory and supervisory systems, and provides support for multilateral and bilateral supervision. IMF technical assistance seeks to strengthen the financial infrastructure of member countries through advice on upgrading their monetary and fiscal management, foreign exchange and capital market development, the design of payment systems and deposit insurance arrangements, and the development of the legal framework for banking. In addition, the IMF works with member countries to establish prudential regulations and supervisory capabilities, especially in the area of entry and exit of banks and strategies for bank systemic restructuring" (Hughes & MacDonald 2002, p. 268).

3. CASE OF TRNC

3.1 The Economy of TRNC

Liberal economic system has been adopted in the TRNC. Under this system the promotion of the private sector, the rational use of natural resources, the encouragement of investments that generate high value added and employment preserve their priority and importance (http://www.cyprusive.com/default.asp?CID=199).

For the assessment of the economic performance in the TRNC the following economic indicators are worth examining.

3.1.1 Growth Rate of Gross National Product (GNP)

The annual average rate of growth realized as 3.6% during the period of 1977-2002. The GNP which was 3,810.5 million TL in 1977 rose to 9,133.1 million TL in 2002 at constant prices of 1977 which accounted for 1,418,703,263.6 million TL at current prices and 941.4 million at US dollar basis.

In 2002, Public Services sector has the highest share in GDP and this sector covers 16%. Trade - Tourism follow it with 15.7% and Transport-Communication with 12.7%.

The developments between 1997-2002 can be seen in the Table 3.1 and Table 3.2 at sectoral basis.

3.1.2 Per Capita GNP

During the period of 1977-2002 annual average increase in GNP per capita has been 2% at constant prices of 1977. The GNP per capita which was 26,279 TL in 1977 rose to 42,780 TL in 2002 at constant prices of 1977 and 6,645,260,285 TL at current prices of 2002 which represents 4,409 US $.

Table 3.1 Gross Domestic Product by Kind of Economic Activity

(At 1977 Producers' Prices, Million TL)

Sectors	1997	GDP (%)	1998	GDP (%)	1999	GDP (%)	2000	GDP (%)	2001	GDP (%)	2002	GDP (%)
1. Agriculture	601.0	7.6	636.2	7.6	822.0	9.1	713.5	7.9	824.4	9.7	985.3	10.9
1.1. Crop Production	261.4	3.3	309.3	3.7	431.5	4.8	336.5	3.7	442.4	5.2	577.5	6.4
1.2. Livestock Production	277.6	3.5	263.8	3.1	302.9	3.4	283.2	3.1	328.3	3.8	343.8	3.8
1.3. Forestry	14.9	0.2	15.7	0.2	40.0	0.4	42.9	0.5	12.7	0.2	15.7	0.2
1.4. Fishing	47.1	0.6	47.4	0.6	47.6	0.5	50.9	0.6	45.0	0.5	48.3	0.5
2. Industry	1,017.7	12.8	1,029.6	12.3	1,054.2	11.7	1,096.0	12.2	1,025.0	12.0	1,075.9	11.9
2.1. Quarrying	26.4	0.3	27.6	0.3	27.9	0.3	31.2	0.4	27.0	0.3	29.0	0.3
2.2. Manufacturing	841.1	10.6	842.9	10.1	853.3	9.5	884.0	9.8	822.8	9.6	869.6	9.6
2.3. Electricity-Water	150.2	1.9	159.1	1.9	173.0	1.9	180.8	2.0	175.2	2.1	177.3	2.0
3. Construction	647.5	8.1	694.6	8.3	708.6	7.8	841.4	9.3	669.6	7.8	776.0	8.6
4. Trade-Tourism	1,317.9	16.5	1,450.9	17.3	1,558.7	17.3	1,474.6	16.4	1,246.4	14.6	1,420.0	15.7
4.1. Wholesale and Retail Trade	1,076.2	13.5	1,201.4	14.3	1,280.9	14.2	1,186.4	13.2	991.8	11.6	1,110.5	12.3
4.2. Restaurants and Hotels	241.7	3.0	249.5	3.0	277.8	3.1	288.2	3.2	254.6	3.0	309.5	3.4
5. Transport-Communication	937.3	11.8	974.6	11.6	1,043.3	11.6	1,113.6	12.3	1,108.2	13.0	1,149.4	12.7
6. Financial Institutions	**482.1**	**6.0**	**524.4**	**6.2**	**568.4**	**6.3**	**529.6**	**5.9**	**434.3**	**5.1**	**390.3**	**4.3**
7. Ownership of Dwellings	428.7	5.4	440.6	5.3	451.7	5.0	461.7	5.1	475.8	5.6	485.1	5.3

8. Business and Personal Services	655.7	8.2	679.2	8.1	784.0	8.7	700.0	7.8	800.1	9.4	807.0	8.9
9. Public Services	1,358.6	17.1	1,406.1	16.8	1,438.6	16.0	1,483.3	16.4	1,461.7	17.1	1,454.3	16.0
10. Import Duties	521.1	6.5	547.6	6.5	584.4	6.5	604.5	6.7	486.2	5.7	519.0	5.7
11. Gross Domestic Product (In Purchasers' Values)	7,967.6	100.0	8,383.8	100.0	9,013.9	100.0	9,018.2	100.0	8,535.7	100.0	9,062.3	100.0
12. Net Factor Income From Abroad	22.8	..	84.3	1.0	76.9	0.9	19.7	0.2	10.2	0.1	70.8	0.8
13. Gross National Product	7,990.4	100.0	8,468.1	101.0	9,090.8	100.9	9,037.9	100.2	8,545.9	100.1	9,133.1	100.8

Source: TRNC Public Information Office, Economic Developments between 1997-2002,

(http://www.trncinfo.com/TANITMADAIRESI/2002/ENGLISH/ECHONOMI/page01.htm).

Table 3.2 Gross Domestic Product by Kind of Economic Activity

(At Current Prices, Million TL)

Sectors	1997	1998	1999	2000	2001	2002
1. Agriculture	8,278,463.6	18,075,858.1	32,647,771.2	44,740,397.7	78,627,217.0	125,668,938.8
1.1. Crop Production	3,912,750.6	9,129,001.3	17,057,377.7	23,638,689.0	41,011,860.7	75,400,813.5
1.2. Livestock Production	3,834,364.0	7,689,166.5	13,405,247.4	18,009,515.3	33,916,132.7	43,670,587.5
1.3. Forestry	42,850.9	74,315.8	294,344.2	484,005.8	253,430.7	389,327.1
1.4. Fishing	488,498.1	1,183,374.5	1,890,801.9	2,608,187.6	3,445,792.9	6,208,210.7
2. Industry	15,701,934.1	28,038,334.1	42,726,134.8	68,385,932.1	121,736,377.0	157,576,560.4
2.1. Quarrying	838,624.4	1,492,631.8	2,248,236.5	3,866,754.8	5,973,198.2	7,823,663.0
2.2. Manufacturing	9,499,365.3	15,710,065.3	25,314,468.5	36,853,966.9	57,236,816.9	74,178,656.2
2.3. Electricity-Water	5,363,944.4	10,835,637.0	15,163,429.8	27,665,210.4	58,526,361.9	75,574,241.2
3. Construction	5,132,410.1	10,131,978.4	16,468,983.9	28,934,272.9	38,923,294.0	62,012,967.1
4.Trade-Tourism	19,413,754.5	38,312,545.4	69,060,910.6	104,703,253.7	165,151,924.5	215,553,627.8
4.1. Wholesale and Retail Trade	14,061,675.1	27,157,588.3	46,746,132.2	65,005,980.0	109,111,187.1	134,383,446.5
4.2. Hotels and Restaurants	5,352,079.4	11,154,957.1	22,314,778.4	39,697,273.7	56,040,737.4	81,170,181.3
5. Transport-Communication	12,329,887.7	22,712,786.8	44,489,843.8	84,621,650.4	133,453,268.5	185,264,817.9
6. Financial Institutions	11,043,010.0	18,702,391.5	25,815,393.3	41,620,313.4	92,762,971.3	89,952,347.0
7. Ownership of Dwellings	3,102,953.6	6,375,054.6	10,302,508.9	15,787,564.6	28,508,816.3	41,431,859.9
8. Business and Personal Services	9,405,482.9	20,675,570.6	38,261,702.8	52,134,500.2	133,995,824.5	138,860,124.0

9. Public Services	22,577,205.8	48,485,813.4	91,039,028.9	155,998,145.8	199,156,534.7	227,867,134.2
10. Import Duties	10,362,183.0	18,823,123.7	32,815,649.5	53,038,365.4	76,836,146.0	113,513,407.6
11. Gross Domestic Product (In Purchasers' Values)	117,347,285.3	231,333,456.6	403,627,927.7	649,964,396.2	1,069,152,373.8	1,407,701,784.7
12. Net Factor Income From Abroad	336,118.5	2,327,348.7	3,441,847.7	1,415,658.8	1,272,099.2	11,001,478.9
13. Gross National Product	117,638,403.8	233,660,805.3	407,069,775.4	651,380,055.0	1,070,424,473.0	1,418,703,263.6

Source: TRNC Public Information Office, Economic Developments between 1997-2002,

(http://www.trncinfo.com/TANITMADAIRESI/2002/ENGLISH/ECHONOMI/page01.htm).

3.1.3 Fixed Capital Investments

For the realization of the growth rate targets set in the long-term plans and annual programs, Turkish Republic of Northern Cyprus was badly in need of financial aid, so certain giant infrastructural projects such as the construction of the airports, sea ports, dams, derivation canals, highways, power plants and the improvement of the telecommunication systems were all financed by the Republic of Turkey. Through the years most of the infrastructural projects have been completed and some are about to be completed. Financial and technical aid of Republic of Turkey for such investments is continued. The fixed capital investments which were realized as 524.6 million TL in 1977 reached 1,282.6 million TL at constant prices of 1977 and 199,231,606.8 million TL at current prices, in 2002.

At the beginning of the planning period the share of the public sector in the fixed capital investments was much higher than the share of the private sector due to intensive infrastructural projects. In recent years the share of the private sector began to rise. The shares of the public and the private sectors in the total fixed capital investments of 2002 reached to 36.4% and 63.6% respectively.

The sectoral distribution of the fixed capital investments during the period of 1997-2002 is shown in Table 3.3.

Table 3.3 Sectoral Distribution of Fixed Capital Investments

(Current Prices, Million TL)

Sectors	1997	1998	1999	2000	2001	2002
1. Agriculture	701,828.8	2,648,109.9	4,367,515.8	6,287,369.1	11,273,995.9	15,876,418.2
2. Industry	1,516,176.8	3,960,064.0	6,830,689.4	13,592,581.5	15,288,051.7	22,529,433.0
2.1.Quarrying	18,436.1	55,350.8	92,068.0	110,035.0	180,013.0	240,120.0
2.2. Manufacturing	945,379.5	2,571,051.5	4,417,114.9	5,234,814.1	10,043,659.0	14,629,250.3
2.3. Electricity-Water	552,361.2	1,333,661.7	2,321,506.5	8,247,732.4	5,064,379.7	7,660,062.7
3. Construction	439,043.6	1,714,261.9	2,096,741.0	2,065,985.6	2,544,432.3	4,327,423.0
4.Trade-Tourism	1,949,012.9	3,910,249.4	5,281,789.6	8,500,384.0	11,290,015.6	19,239,532.6
4.1. Trade	899,533.5	1,709,090.8	1,812,594.3	3,392,070.2	5,467,604.9	8,838,609.5
4.2. Tourism	1,049,479.4	2,201,158.6	3,469,195.3	5,108,313.8	5,822,410.7	10,400,923.1
5. Transport and Communication	3,319,165.1	7,091,180.0	19,463,057.1	15,590,051.2	14,193,791.5	29,705,307.4
6. Financial Institutions	261,534.1	397,338.3	585,382.1	980,516.9	1,193,000.5	1,371,729.5
7. Ownership of Dwellings	9,132,236.9	11,773,932.0	18,095,972.2	26,985,759.6	58,768,951.8	66,347,993.9
8. Business and Personal Services	1,062,220.0	1,595,921.8	3,812,990.2	6,896,702.1	5,518,412.4	7,999,201.9
9. Public Services	3,509,610.0	7,958,459.2	11,292,021.3	21,923,669.5	20,678,926.6	31,834,567.3
9.1. Health	246,286.6	858,481.0	448,622.7	393,273.9	1,632,706.7	1,298,629.4
9.2. Education	1,483,737.4	4,421,697,8	5,694,359.9	9,829,788.3	7,516,154.7	15,117,508.0
9.3. Others	1,779,586.0	2,678,280.4	5,149,038.7	11,700,607.3	11,530,065.2	15,418,429.9
TOTAL	21,890,828.2	41,049,516.5	71,826,158.7	102,823,019.5	140,749,578.3	199,231,606.8

Source: TRNC Public Information Office, Economic Developments between 1997-2002, (http://www.trncinfo.com/TANITMADAIRESI/2002/ENGLISH/ECHONOMI/page01.htm).

3.1.4 Public Finance

The basic aim of the fiscal policy in the Turkish Republic of Northern Cyprus is the creation of the necessary conditions for internal monetary stability, supporting the more productive projects, reducing the budget deficits by limiting the rate of growth of current expenditures, transfers and increasing revenues.

The total local revenues which is composed of tax revenues, non-tax revenues, factor incomes and the social funds, reached to the level of 231.9 million US $ in 2002. The tendency of local revenues can be seen in Table 3.4 prepared at dollar basis.

Until 1975 only 19.6% of the budgetary expenditures were met by the local revenues. In 2002 this ratio rose to 43.6%. Within this context the share of the taxes in the GNP rose from 10.7% in 1977 to 16.1% in 2002.

The breakdown of state revenues and expenditures and the balance of resources and expenditures are seen in the Table 3.5 and Table 3.6 respectively.

Table 3.4 Outline of State Revenues and Expenditures

(Million US $)

	1997	1998	1999	2000	2001	2002
1. Total Revenues	323.8	403.6	455.1	530.4	418.2	531.8
1.1. Local Revenues	222.0	239.3	268.1	291.0	222.3	231.9
1.2. Foreign Aid and Loans	101.8	164.3	187.0	239.4	195.9	299.9
1.2.1. Foreign Aid	63.1	72.5	72.9	102.7	49.8	74.8
1.2.2. Loans	38.7	91.8	114.1	136.7	146.1	225.1
2. Total Expenditures	323.8	403.6	455.1	530.4	418.2	531.8
2.1. Current Expenditures	131.5	150.0	179.8	206.1	137.8	146.4
2.2. Transfers	125.0	156.9	175.5	227.8	221.6	302.0
2.3. Defense	27.9	41.9	53.1	38.8	29.6	35.8
2.4. Investments	39.4	54.8	46.7	57.7	29.2	47.6

Annual average exchange rates at dollar basis;

1997 1 US $ = 154,893.30 TL

1998 1 US $ = 262,384.34 TL

1999 1 US $ = 422,312.61 TL

2000 1 US $ = 626,397.67 TL

2001 1 US $ = 1,177,869.59 TL

2002 1 US $ = 1,507,051.97 TL

Source: TRNC Public Information Office, Economic Developments between 1997-2002, (http://www.trncinfo.com/TANITMADAIRESI/2002/ENGLISH/ECHONOMI/page01.htm).

Table 3.5 Breakdown of State Revenues and Expenditures

(At Current Prices, Million TL)

Sectors	1997	1998	1999	2000	2001	2002
1. Local Revenues	34,385,089.9	62,798,381.2	113,210,292.6	182,290,670.1	261,902,473.9	349,495,497.3
1.1. Taxes	25,100,952.4	47,704,832.3	83,923,670.7	126,376,196.1	179,519,586.9	228,729,649.2
1.1.1 Direct Taxes	14,161,807.2	26,699,107.9	48,648,123.7	74,487,604.5	101,059,993.5	114,648,012.9
1.1.2. Indirect Taxes	10,939,145.2	21,005,724.4	35,275,547.0	51,888,591.5	78,459,593.4	114,081,636.3
1.2. Other Income	6,551,492.3	12,400,201.6	21,006,805.1	37,980,427.9	57,137,840.4	84,462,631.6
1.3. Fund Revenues	2,732,645.2	2,693,347.3	8,279,816.8	17,934,046.1	25,245,046.6	36,303,216.5
2. Expenditures	50,160,862.0	105,910,719.5	192,191,956.4	332,228,068.4	492,609,666.7	801,470,483.8
2.1. Current Expenditures	20,375,173.6	39,372,738.5	75,952,566.0	129,126,690.9	162,283,573.5	220,646,137.4
2.1.1. Personnel Expenditures	17,756,985.3	34,074,324.2	65,793,169.1	113,053,504.6	137,522,686.8	186,722,954.6
2.1.2. Other Current Expenditures	2,618,188.3	5,298,414.3	10,159,396.9	16,073,186.2	24,760,886.7	33,923,182.8
2.2. Transfers	19,359,870.8	41,169,950.9	74,113,905.0	142,693,624.5	261,048,321.4	455,145,454.4
2.2.1. Social Transfers	13,945,813.8	28,169,090.1	50,187,618.5	88,867,822.1	124,691,894.2	161,351,749.3
2.2.2. Other Transfers	5,414,057.0	13,000,860.8	23,926,286.5	53,825,802.3	136,356,427.2	293,793,705.1
2.3. Defense Expenditures	4,325,000.0	11,000,000.0	22,421,093.0	24,275,000.0	34,870,000.0	54,000,000.0
2.4. Investments	6,100,817.6	14,368,030.1	19,704,392.4	36,132,753.0	34,407,771.8	71,678,892.0
3. Foreign Aid and Loans	15,775,772.1	43,112,338.3	78,981,663.8	149,937,398.3	230,707,192.8	451,974,986.5
3.1. Foreign Aid	9,783,860.6	19,019,387.5	30,784,234.5	64,319,691.9	58,587,796.0	112,720,253.8
3.1.1. Aid From Turkey	9,674,231.3	18,958,063.1	30,720,467.1	64,188,138.2	58,476,358.8	111,582,343.1
3.1.2. Other Foreign Aid	109,629.3	61,324.4	63,767.4	131,553.8	111,437.2	1,137,910.7
3.2. Loans	5,991,911.5	24,092,950.8	48,197,429.3	85,617,706.4	172,119,396.8	339,254,732.7
3.2.1. Internal Loans	3,494,295.7	7,770,182.1	28,113,118.8	42,973,802.3	26,619,653.5	34,350,227.9

3.2.2. Foreign Loans	2,497,615.8	16,322,768.7	20,084,310.5	42,643,904.1	145,499,743,3	304,904,504.8
GNP	117,683,403.8	233,660,805.3	407,069,775.4	651,380,055.0	1,070,424,473.0	1,418,703,263.6

Source: TRNC Public Information Office, Economic Developments between 1997-2002,

(http://www.trncinfo.com/TANITMADAIRESI/2002/ENGLISH/ECHONOMI/page01.htm).

Table 3.6 Balance of Resources and Expenditures

(At Current Prices, Million TL)

Sectors	1997	1998	1999	2000	2001	2002
1. Total Resources	124,034,029.1	260,712,630.8	445,204,604.1	671,925,898.6	1,090,566,043.0	1,398,132,003.8
1.1. GNP	117,683,403.8	233,660,805.3	407,069,775.4	651,380,055.0	1,070,424,473.0	1,418,703,263.6
1.2. Current Account Deficit	6,350,625.3	27,051,825.5	38,134,828.7	20,545,843.6	20,141,570.0	-20,571,259.8
2. Total Investments	24,127,203.2	45,462,584.3	79,194,189.9	112,472,551.5	157,286,379.1	224,436,826.2
2.1. Fixed Capital Investments	21,890,828.2	41,049,516.5	71,826,158.7	102,823,019.5	140,749,578.3	199,231,606.8
2.1.1. Public	6,555,971.6	16,732,472.2	29,220,464.3	41,488,121.6	40,991,559.2	72,427,431.4
2.1.2. Private	15,334,856.6	24,317,044.3	42,605,694.4	61,334,897.9	99,758,019.1	126,804,175.4
2.2. Change in Stocks	2,236,375.0	4,413,067.8	7,368,031.2	9,649,532.0	16,536,800.8	25,205,219.4
2.2.1. Public	854,841.5	1,600,426.7	2,140,660.6	2,802,115.0	6,909,385.3	6,156,369.8
2.2.1. Private	1,381,533.5	2,812,641.1	5,227,370.6	6,847,417.0	9,627,415.5	19,048,849.6
3. Total Consumption	99,906,825.9	215,250,046.5	366,010,414.2	559,453,347.1	933,279,663.9	1,173,695,177.6
3.1. Public	29,112,466.5	61,016,776.0	112,440,043.7	178,984,668.9	233,532,591.0	322,959,794.0
3.2. Private	70,794,359.4	154,233,270.5	253,570,370.5	380,468,678.2	699,747,072.9	850,735,383.6
4. Total Gross Domestic Savings (GNP-Total Consumption)	17,776,577.9	18,410,758.8	41,059,361.2	91,926,707.9	137,144,809.1	245,008,086.0

Source: TRNC Public Information Office, Economic Developments between 1997-2002,

(http://www.trncinfo.com/TANITMADAIRESI/2002/ENGLISH/ECHONOMI/page01.htm).

3.1.5 Foreign Trade

The economy of TRNC has the characteristics of an island economy with limited resources.

During the period of 1977-2002 there was an increase in the volume of the foreign trade. The volume of foreign trade which was 105.9 million in 1977 rose to 355 million dollars in 2002. During this period the imports of the TRNC increased from 82 million dollars in 1977 to 309.6 million dollars in 2002, while the exports rose from 23.9 million dollars in 1977 to 45.4 million dollars in 2002. The foreign trade deficit, which was 58.1 million dollars in 1977, reached 264.2 million dollars in 2002. The foreign trade is shown in Table 3.7.

Table 3.7 Foreign Trade

(Million US $)

	1997	1998	1999	2000	2001	2002
Imports	356.6	430.5	412.7	424.9	272.0	309.6
Export	57.7	53.4	52.4	50.4	34.6	45.4
Foreign Trade Deficit	298.9	377.1	360.3	374.5	237.4	264.2

Source: TRNC Public Information Office, Economic Developments between 1997-2002, (http://www.trncinfo.com/TANITMADAIRESI/2002/ENGLISH/ECHONOMI/page01.htm).

Export earnings met 29.1% of the total imports in 1977, 36.6% in 1978, 43.4% in 1979 and 50.1% in 1980. These favorable developments did not continue in the subsequent years and fluctuated below 50% dropping finally to 14.7% in 2002.

TRNC has adopted a liberal trade policy and practices no discrimination against any foreign country. It has succeeded in establishing trade relations with more than 60 countries all over the world. The share of Turkey and other countries and, the foreign trade by countries can be seen in the Table 3.8 and Table 3.9.

Table 3.8 Foreign Trade by Turkey and Other Countries

(Million US $)

Years	Turkey				Other Countries				Total	
	Imports	Share %	Exports	Share %	Imports	Share %	Exports	Share %	Imports	Exports
1997	202.0	56.6	27.1	47.0	154.6	43.4	30.6	53.0	356.6	57.7
1998	251.5	58.4	27.0	50.6	179.0	41.6	26.4	49.4	430.5	53.4
1999	256.4	62.1	27.9	53.2	156.3	37.9	24.5	46.8	412.7	52.4
2000	275.1	64.7	18.7	37.1	149.8	35.3	31.7	62.9	424.9	50.4
2001	173.5	63.8	12.8	37.0	98.5	36.2	21.8	63.0	272.0	34.6
2002	195.0	63.0	18.3	40.3	114.6	37.0	27.1	59.7	309.6	45.4

Source: TRNC Public Information Office, Economic Developments between 1997-2002, (http://www.trncinfo.com/TANITMADAIRESI/2002/ENGLISH/ECHONOMI/page01.htm).

Table 3.9 Foreign Trade By Countries

(Million US $)

	1997		1998		1999		2000		2001		2002	
	Imp.	Exp.	Imp.	Exp.	Imp.	Exp.	Imp.	Exp.	Imp.	Exp.	Imp.	Exp.
Turkey	202.0	27.1	251.5	27.0	256.4	27.9	275.1	18.7	173.5	12.8	195.0	18.3
Other Countries	154.6	30.6	179.0	26.4	156.3	24.5	149.8	31.7	98.5	21.8	114.6	27.1
1. EC Countries	87.5	23.9	113.2	22.3	99.8	20.4	103.2	20.3	63.1	12.2	76.2	12.7
1.1. United Kingdom	45.1	15.0	54.4	16.5	47.4	15.9	43.3	18.8	28.6	11.5	34.2	11.9
1.2. Other EC Countries	42.4	8.9	58.8	5.8	52.4	4.5	59.9	1.5	34.5	0.7	42.0	0.8
2. Middle East Countries	5.4	1.9	5.3	1.5	4.9	2.2	7.5	3.9	10.5	2.9	9.7	3.7
3. Far East Countries	11.0	-	8.2	-	8.1	-	6.3	-	2.6	-	2.5	-
4. USA	2.9	0.3	7.0	0.2	6.3	-	5.2	0.2	4.1	0.5	3.1	0.1
5. Other Countries	47.8	4.5	45.3	2.4	37.2	1.9	27.6	7.3	18.2	6.2	23.1	10.6
TOTAL	356.6	57.7	430.5	53.4	412.7	52.4	424.9	50.4	272.0	34.6	309.6	45.4

Source: TRNC Public Information Office, Economic Developments between 1997-2002, (http://www.trncinfo.com/TANITMADAIRESI/2002/ENGLISH/ECHONOMI/page01.htm).

Agricultural and industrial products including processed agricultural goods are worth mentioning in the overall exports of the Turkish Republic of Northern Cyprus . The share of the agricultural products which accounted for 77.5% of the total exports in 1977 dropped to 41.6% in 2002. As for the share of the industrial products in the total exports increased from 12.1% in 1977 to 57.5% in 2002 (Table 3.10).

The main agricultural and industrial products including agricultural based processed goods exported from TRNC can be seen from the following items:

Citrus

Readymade Clothes

Dairy Products

Concentrated Citrus

Alcoholic Beverages

Medicine

Cigarette

Hides and Leather

The Value of the Imports by Commodity Groups for the years 1997-2002 is seen from Table 3.11.

Table 3.10 Composition of the Exports

(Million US $)

	1997	%	1998	%	1999	%	2000	%	2001	%	2002	%
1. Agricultural Products	18.5	32.1	14.8	27.7	20.1	38.4	16.0	31.7	12.3	35.5	18.9	41.6
1.1. Citrus	15.1	26.2	12.8	24.0	12.1	23.1	13.4	26.6	9.9	28.6	17.1	37.7
1.2. Potatoes	0.4	0.7	0.6	1.1	0.1	0.2	0.1	0.2	0.5	1.4	0.2	0.4
1.3. Other	3.0	5.2	1.4	2.6	7.9	15.1	2.5	4.9	1.9	5.5	1.6	3.5
2. Industrial Products	38.5	66.7	38.3	71.7	32.1	61.2	34.2	67.9	21.9	63.3	26.1	57.5
2.1. Processed Agricultural Goods	11.8	20.4	13.6	25.5	12.5	23.8	12.2	24.2	8.1	23.4	12.2	26.9
2.2. Clothing	24.0	41.6	21.5	40.2	17.8	34.0	19.3	38.3	11.1	32.1	10.9	24.0
2.3. Others	2.7	4.7	3.2	6.0	1.8	3.4	2.7	5.4	2.7	7.8	3.0	6.6
3. Minerals	0.7	1.2	0.3	0.6	0.2	0.4	0.2	0.4	0.4	1.2	0.4	0.9
TOTAL	57.7	100.0	53.4	100.0	52.4	100.0	50.4	100.0	34.6	100.0	45.4	100.0

Source: TRNC Public Information Office, Economic Developments between 1997-2002,

(http://www.trncinfo.com/TANITMADAIRESI/2002/ENGLISH/ECHONOMI/page01.htm).

Table 3.11 Value of Imports by Commodity Groups

(Million US $)

Items	1997	%	1998	%	1999	%	2000	%	2001	%	2002	%
1. Food, Live Animals	60.2	16.9	70.3	16.3	53.0	12.8	60.6	14.3	46.2	17.0	43.5	14.1
2. Beverages and Tobacco	22.1	6.2	28.4	6.6	26.5	6.4	26.9	6.3	19.3	7.1	24.4	7.8
3. Crude Materials, Inedible Other Than Fuels	6.3	1.8	6.7	1.5	5.6	1.4	6.0	1.4	4.5	1.6	4.4	1.4
4. Mineral Fuels, Lubricants and Related Materials	37.3	10.5	30.9	7.2	32.9	8.0	44.4	10.5	32.6	12.0	27.4	8.9
5. Animal and Vegetable Oils and Fats	2.9	0.8	5.0	1.2	4.1	1.0	3.5	0.8	3.0	1.1	3.6	1.2
6. Chemicals	33.1	9.3	36.5	8.5	35.9	8.7	35.0	8.2	28.5	10.5	33.1	10.7
7. Manufactured Goods Classified Mainly by Materials	81.1	22.7	94.2	21.9	85.4	20.7	91.0	21.4	58.3	21.4	73.5	23.7
8. Machinery and Transport Equipment	85.5	24.0	126.0	29.3	135.9	32.9	125.5	29.6	59.0	21.7	74.1	23.9
9. Miscellaneous Manufactured Goods	28.1	7.9	32.5	7.5	33.4	8.1	32.0	7.5	20.6	7.6	25.8	8.3
TOTAL	356.6	100.0	430.5	100.0	412.7	100.0	424.9	100.0	272.0	100.0	309.6	100.0

Source: TRNC Public Information Office, Economic Developments between 1997-2002,

(http://www.trncinfo.com/TANITMADAIRESI/2002/ENGLISH/ECHONOMI/page01.htm).

3.1.6 Balance of Payments

Foreign Trade

During the period of 1997-2002 the exports decreased from 57.7 million dollars in 1997 to 45.4 million dollars in 2002 and imports decreased from 356.6 million dollars to 309.6 million dollars, consequently the foreign trade deficit decreased from 298.9 million dollars in 1997 to 264.2 million dollars in 2002 (Table 3.12).

Invisibles

In the category of invisibles, the net tourism revenues decreased from 183.2 million dollars in 1997 to 114.1 million dollars in 2002. The expenditure incurred by the Turkish Peace Force, the income from the Free Port and Zone, net factor income from abroad (receipts and payment arising from salaries, wages, rents and interest), educational income and expenditure are shown under the item of other invisibles and increased from 74.7 million dollars in 1997 to 163.8 million dollars in 2002.

These developments in the invisible items caused the surplus in the invisibles balance to increase from 257.9 million dollars in 1997 to 277.9 million dollars in 2002. Consequently, the current account deficit decreased from 41.0 million dollars to 13.7 million dollars (Table 3.12).

Capital Movements

The capital movements in the TRNC's Balance of Payments have, except foreign aid provided for long term investments, a short-term characteristic.

During the 1997-2002 period, the foreign aid and loans showed an ascending tendency by increasing from 90.1 million dollars in 1997 to 202.3 million dollars in 2002. The net other capital movements which was -35.2 million dollars in 1997 reached to 14.4 million dollars in 2002.

In conclusion capital movements balance increased from 54.9 million dollars in 1997 to 216.7 million dollars in 2002.

As a result of the above developments the overall balance of foreign payments increased from 13.9 million dollars in 1997 to 230.4 million dollars in 2002 (Table 3.12).

3.1.7 Bank Deposits

Turkish Lira deposits and foreign currency deposits increased from 659.1 million US $ in 1997 to 1,153.5 million US $ in 2002.

The foreign currency deposits which were 454.7million US $ in 1997 increased by 52% and reached to 691.1 million US $ in 2002.

The developments in the bank deposits during the period 1997-2002 are seen in the Table 3.13.

Table 3.12 Balance of Payments

(Million US $)

	1997	1998	1999	2000	2001	2002
1. Current Accounts						
1.1. Foreign Trade						
1.1.1. Exports (Fob)	57.7	53.4	52.4	50.4	34.6	45.4
1.1.2. Imports (Cif)	356.6	430.5	412.7	424.9	272.0	309.6
Trade Balance	-298.9	-377.1	-360.3	-374.5	-237.4	-264.2
1.2. Invisibles Account						
1.2.1. Tourism Revenues (Net)	183.2	186.0	192.8	198.3	93.7	114.1
1.2.2. Other Invisibles (Net)	74.7	88.0	77.2	143.4	126.6	163.8
Invisibles Account Balance	257.9	274.0	270.0	341.7	220.3	277.9
Current Account Balance	-41.0	-103.1	-90.3	-32.8	-17.1	13.7
2. Capital Movements						
2.1. Foreign Aid and Loans	90.1	169.9	96.5	105.5	133.7	202.3
2.1.1. Foreign Aid and Loans by Turkey	88.4	168.7	95.4	105.5	133.7	202.3
2.1.2. Other Foreign Aid	1.7	1.2	1.1	-	-	-
2.2. Other Capital Movements (Net)	-35.2	24.5	35.7	-58.8	9.3	14.4
Capital Movements Balance	54.9	194.4	132.1	46.7	143.0	216.7
Overall balance	13.9	91.3	41.8	13.9	125.9	230.4
3. Change In Reserves (Increase (-)/Decrease (+))	0.9	-112.3	-32.1	22.5	-90.7	-219.0
4. Net Errors and Omissions	-14.8	21.0	-9.7	-36.4	-35.2	-11.4

Source: TRNC Public Information Office, Economic Developments between 1997-2002, (http://www.trncinfo.com/TANITMADAIRESI/2002/ENGLISH/ECHONOMI/page01.htm).

Table 3.13 Bank Deposits

(Million US $)

	1997	1998	1999	2000	2001	2002
Turkish Lira Deposits	204.4	236.1	319.6	318.7	291.3	462.4
Foreign Currency Deposits	454.7	499.6	517.6	484.0	514.1	691.1
Total Deposits	659.1	735.7	837.2	802.7	805.4	1,153.5

Source: TRNC Public Information Office, Economic Developments between

1997-2002, (http://www.trncinfo.com/TANITMADAIRESI/2002/ENGLISH/ECHONOMI/page01.htm).

3.1.8 Price Trends

Looking at the price trends in the TRNC, changes in the consumer price indices show that, a high rate of inflation has been prevailing in the Turkish Republic of Northern Cyprus. Although it went up as high as 93.0% in 1980 it declined in the subsequent years. But these positive developments were deteriorated in 1984 when the consumer price index growth rate rose again to the level of 70.7%. During the period of 1985-1987 it prevailed between 40-48% but in 1988 the inflation began soaring again and it reached 81.7% in 1997. The following Table 3.14 shows the changes in the consumer price indices for the years 1997-2002.

Table 3.14 Changes in Price Indices

Years	Change (%)
1997	81.7
1998	66.5
1999	55.3
2000	53.2
2001	76.8
2002	24.5

Source: TRNC Public Information Office, Economic Developments between 1997-2002, (http://www.trncinfo.com/TANITMADAIRESI/2002/ENGLISH/ECHONOMI/page01.htm).

3.1.9 Employment

The employment policy aims at attaining full employment and the systematic promotion of schemes for the training and re-training of the labour force for increasing productivity and eventually the most efficient utilization of manpower.

There is not any acute unemployment in the TRNC. The average number of registered unemployed which was 1,337 in 1977 reached to 1,535 in 2002 and eventually the unemployment ratio which was 2.9% in 1977, dropped to only 1.6% in 2002.

During the period of 1977-2002 the working population has increased by 107.9%. The working population, which was 44,795 in 1977, rose to 93,114 and constituted 43.6% of the midyear population, which reached 213,491 in 2002. During this period 48,319 people were employed in the economy but they were mostly employed in the services sector and consequently lack of productivity and disguised unemployment were the two important question requiring solution.

The sectoral distribution of the working population is shown in Table 3.15 (TRNC Public Information Office, Economic Developments between 1997-2002, (http:// www.trncinfo.com/TANITMADAIRESI/2002/ENGLISH/ECHONOMI/page01.htm).

Table 3.15 Employment by Sectors

Sectors	1997	1998	1999	2000	2001	2002
1. Agriculture	16,188	15,864	15,547	15,236	14,931	14,632
2. Industry	8,428	8,481	8,552	8,715	8,715	8,891
2.1. Quarrying	1,014	1,037	1,043	1,105	1,105	1,146
2.2. Manufacturing	6,120	6,125	6,153	6,234	6,234	6,364
2.3. Electricity-Water	1,294	1,319	1,356	1,376	1,376	1,381
3. Construction	11,547	12,177	12,361	14,104	14,104	15,786
4. Trade-Tourism	8,730	9,095	9,536	9,630	9,630	10,520
4.1. Trade	5,535	5,826	6,000	6,000	6,000	6,325
4.2. Tourism	3,195	3,269	3,536	3,630	3,630	4,195
5. Transport and Communication	7,192	7,389	7,747	8,104	8,104	8,310
6. Financial Institutions	2,693	2,858	3,026	2,397	2,397	2,397
7. Professional Services	11,454	11,750	13,057	13,057	14,401	14,494
8. Public Services (x)	16,972	17,399	17,689	18,084	18,084	18,084
Total Employment	83,204	85,013	87,515	89,327	90,366	93,114

(x) Includes employment in State Economic Enterprises (SEE) and municipalities.

Source: TRNC Public Information Office, Economic Developments between 1997-2002, (http://www.trncinfo.com/TANITMADAIRESI/2002/ENGLISH/ECHONOMI/page01.htm).

3.2 Current Position and Importance of the Banking Sector

The number of banks in TRNC has drastically gone down from 37 in 1999 to the current 25. The driving force behind this fall has been the economic and financial crises, which swept the country starting from late 1999 through 2000 and most of 2001.

These 25 banks are now functioning under the new Banking Law that has come into force in November 2001. These banks are listed in Table 3.16. The new law includes a large number of amendments in its content (when compared with the original 1976 law) in an attempt to safeguard the banking system against future probable crises (http://www1.dogus.edu.tr/dogustru/journal/cilt_4_sayi_2/M00097.pdf). Jenkins (2004) noted that according to this new law the banking sector has become closer to EU norms.

Table 3.16 Currently Operating Banks in TRNC

	Name of the Bank	Ownership
1	Cyprus Vakıflar Bank Ltd.	State
2	Mediterranean Guarantee Bank Ltd.	State
3	Cyprus Turkish Cooperative Central Bank Ltd.	Private
4	Turkish Bank Ltd.	Private
5	Limassol Turkish Cooperative Bank Ltd.	Private
6	Asbank Ltd.	Private
7	Cyprus Economy Bank Ltd.	Private
8	Artam Bank Ltd.	Private
9	Cyprus Altınbaş Bank Ltd.	Private
10	Rumeli Bank Ltd.	Private
11	Deniz Bank Ltd.	Private
12	Near East Bank Ltd.	Private
13	Şeker Bank (KIBRIS) Ltd.	Private
14	Akfinans Bank Ltd.	Private
15	Yeşilada Bank Ltd.	Private
16	Universal Bank Ltd.	Private
17	Cyprus Continental Bank Ltd.	Private
18	Viya Bank Ltd.	Private
19	Faisal Islamic Bank of Cyprus Ltd.	Private
20	T.C. Ziraat Bankası	Branch Office
21	Türkiye Halk Bankası A.Ş.	Branch Office
22	HSBC Bank A.Ş.	Branch Office
23	Türkiye İş Bankası A.Ş.	Branch Office
24	Oyak Bank A.Ş.	Branch Office
25	Türkiye Garanti Bankası A.Ş.	Branch Office

Source: TRNC Central Bank, 2004, Banks (http://www.kktcmb.trnc.net/ENGLISH/banks/banks-eng.html).

The amount of total assets of the commercial banks was 2,253,162,152 million TL at the end of 2002, and it has increased to 2,899,460,928 million TL at the end of 2003 (TRNC Central Bank, 2004, Data (http://www.kktcmb.trnc.net/ENGLISH/DATA/dataall.html)).

Along with the 25 local banks, there are 21 off-shore banks operating in the TRNC (TRNC Central Bank, 2004, Banks (http://www.kktcmb.trnc.net/ENGLISH/banks/banks-eng.html). Most of the off-shore banks are owned and operated by their parent banking corporations headquartered in Turkey (http://www1.dogus.edu.tr/dogustru/journal/cilt_4_sayi_2/M00097.pdf).

In an interview I conducted on 19 July 2004, Mr. R. Erkiner said that the establishment of a bank or the opening of a branch by a foreign bank for the purpose of carrying on business within TRNC is subject to authorisation by the Central Bank of TRNC, that provides limited monetary policy.

In an interview I conducted on 19 July 2004, Mr. T. Ekdal said that according to Banking Act № 39/2001 the minimum paid-up or allotted capital of banks is 2,000,000 USA dollars on establishment of a bank. Jenkins (2004) noted that the banks having a level of capital less than this amount will have to increase their capitals up to this level until the end of 2004.

The share of the banking sector in GDP has been steadily going down since 1999, until then it had followed an upward trend. Its share was 6.3% with 568.4 million TL (in 1977 prices) in 1999 and has decreased to 4.3% with 390.3 million TL in 2002 (in

1977 prices – see Table 3.1). Again, the economic crises have been the main driving force behind this decline.

As seen from Table 3.17 (Real Growth Rates), almost all sectors in the TRNC economy have been considerably affected by the economic crises after 1999. The growth rates, which had been in an upward trend until then, dropped heavily in 2000 and 2001. However, the downward trend is stabilized for 2002, except for the Public Services and the Financial Institutions sectors. It seems that the recovery for the banking sector will take a longer time as still a negative growth rate is projected for this vital sector of the TRNC economy. A negative growth rate of -10.1% is the lowest among all sectors for 2002.

Table 3.17 Real Growth Rates of Sectoral Value Added (%)

Sectors	1997	1998	1999	2000	2001	2002
1. Agriculture	-31.0	5.9	29.2	-13.2	16.1	18.9
1.1. Crop Production	-34.4	18.3	39.5	-22.0	31.5	30.5
1.2. Livestock Production	2.3	-5.0	14.8	-6.5	15.9	4.7
1.3. Forestry	-90.4	5.4	154.8	7.3	-70.4	23.6
1.4. Fishing	3.7	0.6	0.4	6.9	-11.6	7.3
2. Industry	3.6	1.2	2.4	4.0	-6.5	5.0
2.1. Quarrying	8.2	4.3	1.2	11.8	-13.5	7.4
2.2. Manufacturing	3.1	0.2	1.2	3.6	-6.9	5.7
2.3. Electricity - Water	5.7	5.9	8.7	4.5	-3.1	1.2
3. Construction	23.7	7.3	2.0	18.7	-20.4	15.9
4. Trade-Tourism	5.9	10.1	7.4	-5.4	-15.5	13.9
4.1. Wholesale and Retail Trade	4.1	11.6	6.6	-7.4	-16.4	12.0
4.2. Hotels and Restaurants	14.6	3.2	11.3	3.7	-11.7	21.0
5. Transport-Communication	9.4	4.0	7.0	6.7	-0.5	3.7
6. Financial Institutions	**13.8**	**8.8**	**8.4**	**-6.8**	**-18.0**	**-10.1**
7. Ownership Of Dwellings	2.8	2.8	2.5	2.2	3.1	2.0
8. Business and Personal Services	26.5	3.6	15.5	-10.7	14.3	0.9
9. Public Services	0.6	3.5	2.3	3.1	-1.5	-0.5
10. Import Duties	15.9	5.1	6.7	3.4	-19.6	6.7
11. GDP	4.3	5.2	7.5	..	-5.4	6.2
12. Net Factor Income From Abroad	-36.1	269.3	-8.8	-74.4	-48.2	594.1
GNP	4.1	6.0	7.4	-0.6	-5.4	6.9

Source: TRNC State Planning Organization, 2004, Economic and Social Indicators (1995-2002),

(http://www.devplan.org/eng_ind.html).

Table 3.18 Sectoral Distribution of Working Population

Sectors	1997	%	1998	%	1999	%	2000	%	2001	%	2002	%
1. Agriculture	16,188	19.5	15,864	18.7	15,547	17.8	15,236	17.1	14,931	16.5	14,632	15.7
2. Industry	8,428	10.1	8,481	10.0	8,552	9.8	8,715	9.6	8,715	9.6	8,891	9.5
2.1. Quarrying	1,014	1.2	1,037	1.2	1,043	1.2	1,105	1.2	1,105	1.2	1,146	1.2
2.2. Manufacturing	6,120	7.3	6,125	7.2	6,153	7.0	6,234	7.0	6,234	6.9	6,364	6.8
2.3. Electricity – Water	1,294	1.6	1,319	1.6	1,356	1.5	1,376	1.5	1,376	1.5	1,381	1.5
3. Construction	11,547	13.9	12,177	14.3	12,361	14.1	14,104	15.8	14,104	15.6	15,786	17.0
4. Trade-Tourism[1]	8,730	10.5	9,095	10.6	9,536	10.9	9,630	10.8	9,630	10.7	10,520	11.3
4.1. Wholesale and Retail Trade	5,535	6.7	5,826	6.8	6,000	6.9	6,000	6.7	6,000	6.7	6,325	6.8
4.2. Hotels and Restaurants	3,195	3.8	3,269	3.8	3,536	4.0	3,630	4.1	3,630	4.0	4,195	4.5
5. Transport-Communication	7,192	8.6	7,389	8.7	7,747	8.8	8,104	9.1	8,104	9.0	8,310	8.9
6. Financial Institutions	**2,693**	**3.2**	**2,858**	**3.4**	**3,026**	**3.5**	**2,397**	**2.7**	**2,397**	**2.7**	**2,397**	**2.6**
7. Business and Personal Services[2]	11,454	13.8	11,750	13.8	13,057	14.9	13,057	14.6	14,401	15.9	14,494	15.6
8. Public Services[3]	16,972	20.4	17,399	20.5	17,689	20.2	18,084	20.2	18,084	20.0	18,084	19.4
Total Employment	83,204	100.0	85,013	100.0	87,515	100.0	89,327	100.0	90,366	100.0	93,114	100.0

[1]Trade and tourism sectors were considered separately after 1982.

[2]Business and Personal services were included in Public Services before 1983.

[3]SEE and Municipalities are included.

Source: TRNC State Planning Organization, 2004, Economic and Social Indicators (1995-2002), (http://www.devplan.org/eng_ind.html).

The banking sector had been booming until the crisis and a true indication of this had been the number of people employed in the sector. Until 2000, both the employment and its share in the economy had been increasing; however, due to a decrease in number of banks by 12 as a result of the banking crisis, these figures have gone down in the recent years. In 2002, only 2.6% (2,397 people) of the working population is employed in the sector, and this number is equal to the sector's share of back in 1988 (see Table 3.18).

Before the banking crisis, there had been a steady increase in deposits hold at the banks as seen in Table 3.19, with the maximum reached with 837.2 million USD at the end of 1999. The crisis not only hampered the banks' reliability but also gave rise to a major decline in the amount of deposits as a direct consequence of this reliability syndrome. A decline by 4.12% in 2000 together with an only a fraction of an increase in 2001 are true indicators for the reliability problem in the banking sector. Additionally, lower purchasing power and unemployment as direct consequences of the economic crisis together with stagnation were other factors behind the decline in bank deposits.

On the other hand, it is worth nothing that there has been an increase in deposits in 2002. One reason for this is the obvious reestablishment of the deposit-makers' confidence in the banking sector; the public, once hesitant to make deposits at the banks after the banking crisis, have "come back" and fed the system once again. The other reason for this increase could be due to the still stagnant economy; as seen from Table 3.20, banks have been having a hard time in lending out money as a result of the economic crisis after 1999; the yearly percentage change in loans have been under the inflation rate since the end of 1999. This indicates that there is a very small amount of investment made for businesses and almost no alternative investment instrument (though very few do exist, they are unfortunately not very common among the public yet) in the country and as a result, a large sum of loose money goes into the bank deposits (http://www1.dogus.edu.tr/dogustru/journal/cilt_4_sayi_2/M00097.pdf).

Table 3.19 Deposits at the banks and % change

YEAR	**TL DEPOSITS** (Million TRL)	**FOREIGN CURRENCY DEPOSITS** (USD)	**TOTAL DEPOSITS** (in TRL equivalent, trillion TRL)	**TOTAL DEPOSITS** (in USD equivalent, million USD)	**% Change in Deposits**(in USD equivalent)
1997	41,818,380	454,743,300	134.42	659.1	13.38
1998	73,750,887	499,541,300	229.25	735.7	11.62
1999	172,426,892	517,629,300	529.69	837.2	13.80
2000	213,915,391	484,021,800	538.82	802.7	- 4.12
2001	419,443,317	514,068,300	1,159.6	805.4	0.34
2002	755,561,600	691,100,000	1,884.8	1,153.5	43.22

Source: (http://www1.dogus.edu.tr/dogustru/journal/cilt_4_sayi_2/M00097.pdf).

Table 3.20 Bank Loans

YEAR	**Loans** (Million TL)	**% Change from Previous Year**	**Inflation Rate (Retail Price Index) (%)**
1997	111,655,377	142.48	81.7
1998	236,078,442	111.43	66.5
1999	551,399,571	133.57	55.3
2000	525,201,259	- 4.75	53.2
2001	752,698,681	43.31	76.8
2002	614,815,444	0.92	24.5

Note: In 1998 and 1999, the loans are reported to be greater than the deposits; there could be two reasons for this: either there is a difference in methods used by the Central Bank and the State Planning Organization, especially in using the appropriate exchange rate in converting TL into USD and vice versa or Development Bank's loans have also been taken into account – Development Bank is not a deposit-taker, hence loans could be higher than the deposits.

Source: (http://www1.dogus.edu.tr/dogustru/journal/cilt_4_sayi_2/M00097.pdf).

3.3 Basic Problems of the Banking Sector

The banking sector of TRNC is surrounded by serious structural problems. These problems can be summarized under the following headings (http://www1.dogus.edu.tr/dogustru/journal/cilt_4_sayi_2/M00097.pdf).

3.3.1 Problems of Monetary Policy

The legal tender in TRNC is the Turkish Lira. Because of the use of another country's currency, the TRNC Central Bank has little control over monetary policy. In effect, the only monetary control instrument available to it is the reserve requirement. Currently the minimum reserve requirement on Turkish Lira deposits is 14% and on foreign currency deposits 15%. There is also a liquidity requirement of 10% on all deposits, payment orders and realized tax liabilities. The only liquid assets, which qualify for the liquidity requirement, are:

(a) Cash;

(b) Current account balances at the TRNC Central Bank;

(c) Payable on demand TRNC bonds;

(d) TRNC Development Bank bonds with a maximum maturity of one year;

(e) Discount facility provided by the TRNC Central Bank.

There is no money market in the TRNC; the TRNC Central Bank has tried several times to start an interbank money market, organized within itself, but these attempts have never come to operation. The absence of an interbank money market has meant that the fallout effect of banks becoming insolvent has not directly affected the healthy banks (http://www1.dogus.edu.tr/dogustru/journal/cilt_4_sayi_2/M00097.pdf).

3.3.2 Problems of Banking Operations

Due to the absence of a capital market, the banks are the only conduits for financial intermediation. The TRNC banking sector is not under any strain from financial disintermediation, as is the case in developed economies.

Traditionally the banks have offered depositors limited choice in the type of savings accounts. However, as the depositors become more financially aware, through the economy pages of daily newspapers (local and from Turkey), the demand for other types of financial instruments is being satisfied. This demand is for Turkish Securities and for Turkish Treasury Bonds. Banks operating in TRNC as branches of the mainland Turkish banks have an advantage here, since they are integrated into the Turkish banking sector, and thereby have access to the money and capital markets of

Turkey. Hence, this service began to be provided through these branches as a reaction to depositor demand. Reacting to this demand the local TRNC banks also began to offer these services, though on a much lower level, since they cannot enter the money and capital markets directly, and must go through their correspondent banks.

The standard strategy followed by the TRNC banks has been to seek deposits, which are then channeled into assets such as loans and Turkish Treasury Bonds. Because of the fact that the interest differential between deposits and Turkish Treasury Bonds is usually high enough to warrant banks to hold Treasury Bonds as a major part of their assets, the banks have not been under any pressure to find a strategy, which would stimulate the demand for loans. Branch networks were created to maximize the collection of deposits, this is shown by the fact that there is only one bank branch in the Lefkoşa Organized Industrial Park, and this was opened relatively recently in 1998.

There was no effort by any bank to adopt a strategy to challenge the traditional activity.

All banks followed a reactive strategy, competing with each other according to each bank's own characteristics.

Banking supervision, under the authority of the TRNC Central Bank, also followed a reactive strategy. Until recently, the supervisors seldom visited the banks, due to the fact that the number of banks they had to supervise did not match to the number of bank supervisors. Supervision relied heavily on the monthly reports prepared by each bank and sent to the Central Bank.

However, after the banking crisis of 2000, the TRNC Central Bank began to foster change in the banking sector. Regarding banking supervision as its primary task, the TRNC Central Bank has recruited new personnel for the banking supervision department. The status quo has been shaken up by the issuing of ten new notices by the TRNC Central Bank, regulating everything that banks do. Their strategy is to work proactively with the banks, in order to create a stronger banking sector.

The new regulatory notices are aimed at bringing banking practices into line with international standards, especial attention is being accorded to capital adequacy, with the adoption of the Basle criteria of a minimum 8% capital adequacy ratio. Hence, it can be said that the strategy of the TRNC Central Bank is proactive in the way it is forcing change on the banking sector.

Proactivity in strategic outlook is not confined to the Central Bank, some commercial banks are also rethinking their strategies and attempting to foresee customer demand, and thereby cater for customer needs, which have been identified. The local commercial banks are aware that in order to continue in business and increase value for shareholders, they must actively seek out and identify niche markets, otherwise their existence is under threat coming from the branch offices of the large Turkish banks operating in TRNC (http://www1.dogus.edu.tr/dogustru/journal/cilt_4_sayi_2/M00097.pdf).

In an interview I conducted on 19 July 2004, Mr. T. Ekdal said that the number of banks established in the TRNC market according to the country's population is more than needed. As a result, it is not easy to provide adequate supervision of such number of financial institutions, and the profitability of the banking sector is low.

It is suggested that "increased amount of banks normally brings a high competition between the financial institutions. This increases the cost of deposits and lending. This situation dramatically reduced the total private investments in North Cyprus.

Heavy cost of lending brought financial discomfort to the current accounts of check users. The number of prosecuted accounts to the debt balance of debtors and the number of customers who are restricted from using checks increased dramatically.

The small financial market of North Cyprus and heavy economic disables of the available firms obliges banks to transfer the large portion of available funds to foreign countries for the sake of security in exchange of very small commission or profit margin above the brake even cost of these funds.

High inflation rate ruling in North Cyprus caused suffering to banks' assets and the original capital is such that they do not reflect their real values. Banks are forced to pay corporation tax on the profit, which does not represent the real value of the net profit before tax assessment. In other words, Government Tax Office imposes Corporation Tax without considering the portion in net profit the inflation losses of net capital" (Bıçak & Menteşoğlu 1999, p. 543).

In an interview I conducted on 28 July 2004, Mrs. N. Ö. Güngör said that training and education of banking staff in the local banks are not adequate.

According to Jenkins (2004) banks should never keep their assets in liquid form. Excess liquidity is a sign of some problems in the economy and an extra burden on the finances of the bank, as stagnant money in a cash-desk is not productive.

In an interview I conducted on 19 July 2004, Mr. T. Ekdal said that most of the domestic banks offer the same kind of services in TRNC and don't have local advertising strategy.

As there are no special commercial courts dealing with debt/credit related lawsuits of the banks, solving such matters through the normal legal channels is a lengthy procedure, and this delay, no doubt, is against both debtors and creditors. There is also the problem of technical details to which the normal courts do not pay sufficient attention with the result that their decisions may not always be just.

3.3.3 Problems of Electronic Banking

Starting in late 1980s the local banks began implementing branch automation systems to offer their traditional services like checking & savings accounts, money transfers, trade transactions, but they have not planned, implemented or integrated these systems in way that they would bring them a competitive advantage and help them not to lose any customer to their competitors. In a way, these IT implementations were not a part of a proactive strategy; they were simply aimed to cut down the work load on the banks' own staff and lower expenses – a direct consequence of a reactive thinking ("too much work for staff, high expenses for the bank, do something to ease things").

Things started to change later on in mid 1990s when customers, especially the younger ones, started to demand the same services that others have been receiving in other parts of the world, especially in Turkey. As a result, some local banks realized that they need information systems that are critical for their long-term prosperity and more importantly for their survival. This was then a catalyst for few local banks to reconsider their information systems. They realized that if they had continued to do business as before with their current banking systems, they could have easily lose the competition to other banks, especially to those based in Turkey and having branches in TRNC. A local bank made the initial step with the introduction of ATM services in mid 1990s. The decision for offering ATM services was one of a kind, as it was an outcome of both reactive thinking (same services offered by the Turkish Banks in TRNC) and proactive thinking (act before losing the competition to the Turkish Banks).

In the last few years, the local banks have been eager and fast in getting into the retail banking market through credit cards and POS (point of sale) terminals. The local banks have always had loyal customers, but after the recent striking economic events, customer loyalty has diminished and the local banks started losing customers against their competitor Turkish banks (local branches of the mainland Turkish banks) with extensive retail banking capabilities. In order to compete with their Turkish rivals in the retail field of electronic banking, the local banks offer the same services in cooperation with some banks in Turkey, though less efficiently and with almost no profit. This act has been an outcome of both reactive and proactive thinking such that it is reactive as the efforts have aimed to satisfy the current needs of the customers, and proactive in the sense that the local banks would have otherwise lost their customer portfolio to the Turkish Banks.

It has been a real task for the local banks to offer electronic retail banking services such as overseas fund transfers, credit cards, POS and ATMs as these services require membership to foreign global networks like SWIFT, Visa and Master Card; unfortunately, being operating in an unrecognized country, the local banks have been denied membership to such networks and hence they are currently unable to issue their own international credit cards and register their local ATMs to global networks (even to the Turkish Interbank Card Center network–BKM network). This has created an unfair competition in the banking sector, as the Turkish banks were able to penetrate into the market easily while the locals could only accomplish a minimal success in doing so.

The fact that a local bank should cooperate with another party (a Turkish bank in this case) in order to provide credit card and POS services, negatively affects its operation in terms of high expenses, difficulties in independent operation and decision-making.

Another factor, which directly affects the electronic banking penetration in the sector, is the population size of the country. When combined with the adverse effect of the high number of banks in the sector, the small population and the resulting small customer portfolio per bank make electronic banking investments almost infeasible. Electronic banking services require a high initial investment and a continual operating expenses and it is not feasible to provide such services to customer portfolios in terms of only few thousands. On the other hand, the Turkish banks in TRNC do not make any initial investment as they simply use the already established infrastructure in Turkey; moreover, their operating costs for electronic banking services are much lower due economies of scale.

The local banks have been trying constantly to keep up with the technology and provide the same electronic banking services their Turkish competitors have been providing. The major local banks now offer credit card, POS and ATM services, and a couple of them have on-going internet banking projects; however, due to the unfavorable conditions – operating in an unrecognized country, the small population size (small customer base) and the high number of banks on top of these – electronic banking services offered by the local banks have not reached to a satisfactory level within TRNC (http://www1.dogus.edu.tr/dogustru/journal/cilt_4_sayi_2/M00097.pdf).

3.4 The Extent of Globalization in the Banking Sector

In an interview I conducted on 19 July 2004, Mr. T. Ekdal said that TRNC at the moment is an unrecognized country that encounters political and economical isolation. Although its existence, all countries except Turkey are insistently rejecting the existence of TRNC (http://www1.dogus.edu.tr/dogustru/journal/sayi_6/M0

0079.pdf). Under these conditions, the economy of North Cyprus, and consequently, the banking sector cannot participate in globalization trend in full array and are marginalized from the world marketplace. It can be seen in these: as in an interview I conducted on 19 July 2004, Mr. T. Ekdal said that the local banks cannot provide full range of international banking activities; the banks' guarantorship is not accepted in countries other than Turkey; they cannot establish cross-border mergers; the financial institutions are not able to have access to international networks like SWIFT, with the result that international banking services become more expensive than SWIFT-using banks in other countries. As a result, there is no opportunity for the banking sector to get absolute benefit from globalization.

The extent is reflected in the following:

- In an interview I conducted on 10 May 2004, Mr. T. Altuner said that there is an integration of the TRNC international banking services to other countries' financial systems through correspondent banking; the local banks can provide transfers to any country and can accept transfers from any country.
- In an interview I conducted on 11 August 2004, Mr. E. Raif said that only one local bank – Turkish Bank Ltd. has subsidiaries in foreign countries; they are Turkish Bank A.Ş. in Turkey consisting of the Head Office with its 12 branches and Turkish Bank (UK) Ltd. in England consisting of the Head Office with its 3 branches.
- There are 21 off-shore banks in TRNC, most of them are owned and operated by their parent banking corporations headquartered in Turkey (see Table 3.21);

Table 3.21 Operating Off-Shore Banks

1)	The European Business Bank Ltd.
2)	The European Commerce Bank Off-Shore Ltd.
3)	The Euro Textile Bank Off-Shore Ltd.
4)	İmar Bank Off-shore Ltd.
5)	Atlas Bank Off-Shore Ltd.
6)	World Vakıf Off-Shore Banking Ltd.
7)	Optima Bank Off-Shore Ltd.
8)	Cyprus Islamic Off-Shore Bank Ltd.
9)	First Merchant Bank Off-Shore Ltd.
10)	Şekerbank Off-Shore Ltd.
11)	Cleveland Off-Shore Bank Ltd.
12)	Adabank Off-Shore Ltd.
13)	Euro-Deniz Off-Shore Bank Ltd.
14)	Bank 2000 Off-Shore Ltd.
15)	Renfrew Security Bank & Trust Off-Shore Ltd.
16)	Cardinal Bank of Ottoman Off-Shore Ltd.
17)	Admiral Alliance Off-Shore Bank Ltd.
18)	Ekonomi Bank Off-Shore Ltd.
19)	Rahim Off-Shore Bank Ltd.
20)	Anadolu Bank Off-Shore Ltd.
21)	Allied Turkish Bank Off-Shore Ltd.

Source: TRNC Central Bank, 2004, Banks (http://www.kktcmb.trnc.net/ENGLISH/banks/offshore-banks-eng.html).

- In an interview I conducted on 26 July 2004, Mrs. H. P. Jenkins said that there is liberal capital accounting; no restrictions on capital inflows and capital outflows in regard to foreign countries.
- Considering the indicators of the balances with foreign banks at the ends of 2001, 2002 and 2003 we can say that the amounts of the balances were in growth from year to year; this can be seen in Table 3.4.1; the balances with foreign banks had amounted to 203,295,467 million TL, while total assets

were equal to 1,773,214,149 million TL, as a result 11.5% of total assets were in foreign banks as of 31 Dec 2001; at the end of next year the balances amounted to 369,374,779 million TL, while total assets were equal to 2,253,162,150 millon TL, so 16.4% of total assets were in foreign banks; at the end of 2003 the balances amounted to 545,020,145 millon TL, while total assets were equal to 2,899,460,928 million TL, it means that 18.8% of total assets were in foreign banks (see Table 3.22);

Table 3.22 Bank Balances with Foreign Banks

Date	**Balances with Foreign Banks** (million TL)	**Total Assets** (million TL)	**Share of Balances with Foreign Banks in Total Assets (%)**
31 Dec 2001	203,295,467	1,733,214,149	11.5
31 Dec 2002	369,374,779	2,253,162,150	16.4
31 Dec 2003	545,020,145	2,899,460,928	18.8

Source: TRNC Central Bank, 2004, Data (http://www.kktcmb.trnc.net/ENGLISH/ DATA/dataall.html).

- There are 6 branches of foreign commercial banks. The amount of their total assets in TRNC at the end of 2003 was 820,657,067 million TL (Turkiye Garanti Bankası had not been established yet at the end of 2003) , equivalent to 28,3% share in the total assets of all commercial banks in Northern Cyprus (TRNC Central Bank, 2004, Summary of Assets for 2003, (http://www. kktcmb.trnc.net/ENGLISH/DATA/a-bs-03/ta01aktifozet-eng-03.html), and 2003 year end Balance Sheets of T.C.Ziraat Bankası, Türkiye Halk Bankası

A.Ş., HSBC Bank A.Ş., Türkiye İş Bankası A.Ş., and Oyak Bank A.Ş.). The foreign branches have global reach and they surpass by size, variety and quality of services in comparison with the local banks. As a result the local banks have competition disadvantage.

The international banking activities of TRNC are very limited in the universal scope. All these imply that the extent of globalization in the banking sector of TRNC is minimal.

3.5 Possible Impacts of Globalization on the TRNC Banking Sector in the Light of EU Membership

European countries have taken a number of steps to reduce regulatory barriers to cross-border banking. These steps are known collectively as the "single market" program. Under this program, the European Commission and the European Union (EU) Council of Ministers established directives intended to guarantee equal regulatory treatment of foreign banks by national authorities, unfettered provision of financial services across borders, home-country control of bank supervision, and home-country implementation of bank solvency requirements. The EU Council also passed regulations to liberalize cross-border capital flows and harmonize regulations across member countries that cover capital adequacy, credit exposure, and banks' participation in nonfinancial activities. Most of these directives had been implemented by the mid-1990s. In 1999, eleven members of EU also entered into the European Monetary Union (EMU) and began to trade in a single currency, the euro. The EU

Council has as one of its goals the creation of a single, integrated banking market. An assumption behind such a goal is that cross-border competition fosters efficient, low-cost banking by allowing more efficient banks to move across borders and compete with less-efficient banks formerly protected by their nation's borders. Competition forces the inefficient banks to either improve or to leave the market. As the lowest cost producers of banking services expand across many borders, they drive prices closer to marginal costs (http://www.federalreserve.gov/pubs/bulletin/2003/1103 lead.pdf).

If, TRNC, after possible solution in the island becomes a member of EU, political and economic isolation of North Cyprus automatically will be abolished. The State becoming an EU member automatically will also become a member of EMU. There will be transformation of the TRNC economy. These EU and EMU memberships will bring many opportunities for the economy to participate in the global marketplace. As a result substantial effects on globalization of the TRNC banking sector will occur.

The possible effects on the banking sector:

- In an interview I conducted on 19 July 2004, Mr. T. Ekdal said that the Turkish-Cypriot banks will be able to provide full range of international banking activities;
- the local banks will have ability to act as guarantor in transactions with other countries and to establish cross-border mergers;
- it will be possible for the financial institutions to benefit from modern communication and payment systems.

- The electronic services offered by the local banks will have reached to a satisfactory level, the domestic banks will be able to access to international networks like SWIFT, Visa and Master Card.
- In an interview I conducted on 20 July 2004, Mr. Z. Erkut said that there will be no need for correspondent banking through Turkey to meet the needs of customers from foreign countries except Turkey, as a result, commission charge that is used to spend for correspondent banks in Turkey, after the EU membership, will be left in the Turkish-Cypriot banks.
- In an interview I conducted on 19 July 2004, Mr. T. Ekdal said that the banking sector will be able to become a member of international institutions providing an important role in globalization of banking, such as the BIS.
- "EURO" will be accepted as a medium of exchange, which will be a stable currency. The banks will benefit from this;
- with a stable currency interest rates bankruptcies will go down hence less debt for the banks. In other words there will be lower losses for the banks;
- There will be no initial cost of accepting a local currency (http://www1.dogus.edu.tr/dogustru/journal/sayi_6/M00079.pdf).
- In an interview I conducted on 27 May 2004, Mr. Y. Değirmencioğlu said that the need to keep money in cash will be lowered.
- The intra-European currency risk will be eliminated.
- The sovereign risk will be diminished.
- There will be training staff and changing over their internal accounting and computer systems to the euro from the date of accession;

- new strategic opportunities will be identified and exploited (http://www.dip badajoz.es/eurolocal/entxt/services/quest/7.htm).
- The liberalization of capital flows, the removal of controls and the breakdown of international barriers, make it possible for new entrants to participate in markets which were previously closed to them (http://www.bis.org/revie w/r001024c.pdf).
- The elimination of regulation barriers and foreign exchange risk opens up terrific opportunities to gain economies of scope and scale as well as for diversification and expansion into growth markets;
- there will be opened up new markets for banks, particularly in trading, asset management and investment banking activities (http://www.bis.org/review /r001009c.pdf).
- There will be a freedom of engaging in banking business within the territory of all Union member states without the need of obtaining permits from the authorities of the respective states, i.e. exclusively on basis of a licence to establish a bank issued in the country of origin;
- there will be a freedom of providing banking services in their full array, with no extra authority concerning the various types of activity required;
- there will be a freedom of bank services purchase by customers in various states, country of origin of the bank notwithstanding;
- full freedom in securities trading will be introduced throughout the area of the Single Financial Market (http://www.ce.uw.edu.pl/wydawnictwo/ yearbook_no4/Nowak.pdf).

- In an interview I conducted on 27 May 2004, Mr. Y. Değirmencioğlu said that as the market size expands, the sector's profitability will rise and accumulations of equity will increase.
- As the European System of Central Banks (ESCB) "comprises the national central banks of the member states" (Hitiris 1998, p. 51), the Central Bank of TRNC will become also a participant in the ESCB. The statute of the Central Bank will be harmonized with the statute of the European Central Bank (ECB) and the ESCB.
- Although the Central Bank at the current moment provides limited monetary policy, the membership in the ESCB means for the Central Bank that it will lose out its right to formulate and conduct its monetary policy as the single monetary policy within EMU is conducted by the ECB.
- "National payments systems will be linked to each other via a new system, called TARGET, which will also be used by the ECB to execute its monetary policy directly in euro" (Gros & Thygesen 1998, p. 263). So, the TRNC national payment system will also be linked to this system from the date of full accession.
- One of the tasks of the ESCB is to "contribute to the smooth conduct of policies pursued by the competent authorities relating to the prudential supervision of credit institutions and the stability of the financial system" (Gros & Thygesen 1998, p. 476) in the euro-area. So, the controls will make sure banks are fundamentally financially sound (http://www1.dogus.edu.tr/dogustru/journal/sayi_6/M00079.pdf).

- In an interview I conducted on 19 July 2004, Mr. R. Erkiner said that there will be more prudential control on providing loans and accepting deposits.
- The ECB, which is designed by the architects of the Maastricht Treaty, is the guarantor of low and stable inflation in the Euro-zone;
- the inflation accounting will be excluded (www1.dogus.edu.tr/dogustru /journal/sayi_6/M00079.pdf).
- The low level of inflation which means automatically lower level of interest rates, which are relatively high at the present moment in TRNC. And for the banking sector it means lower interest rates both of credits and deposits.
- Businesses will be doing better with low and stable interest rates and with a healthy small business sector (www1.dogus.edu.tr/dogustru/journal/sayi_6/M0 0079.pdf).
- Furthermore, the credibility and stability of the banking sector will be increased, because of gradual implementation of the EU banking laws' basic principles, prudential regulations and provisions (equity, solvency ratio, concentration limits, capital adequacy, consolidated supervision). The safety will be additionally enhanced by implementing EU laws on prevention of money laundering. Moreover, EU regulations warrant a very high level of customer protection (deposit guarantee system, consumer credit regulations etc.).
- The more credible and stable financial institutions of North Cyprus considering a stable currency, elimination of exchange rate risk, optimum capital allocation, increased transparency and comparability of prices of banking services, provision of a large range of products, a broad range of

maturities, a high level of liquidity and low transaction costs will attract an enormous amount of international custom and will attract both international investors and borrowers. The concentration of transactions on a currency will be fostered by economies of scale (http://www.bis.org/review/r981120c.pdf). The demand for "Euro" funds will increase (http://www1.dogus.edu.tr/dogus tru/journal/sayi_6/M00079.pdf).

- There will be also new operational and credit risks.
- Foreign banks will move to expand into North Cyprus.
- The availability of foreign finance for domestic borrowers will be increased.
- There will be a common monetary framework, the use of a single currency – the euro in the European single market, transparency and easier comparability of prices of banking services across the participating Member States. These factors will lead to increased competition between the EU banks (http:// www.dip-badajoz.es/eurolocal/entxt/services/quest/7.htm). So, the TRNC banking sector will face tougher competition.
- The increased competition makes new demands on old established enterprises and they must either adapt or die (http://www.bis.org/review/r001024c.pdf). So, this stronger competition will lead up probably to eliminating less competitive banks and financial institutions from the euro-zone.
- The introduction of the euro and increased competition will encourage domestic and cross-border banking consolidations in the form of mergers and acquisitions in order to strengthen position of the financial institutions of North Cyprus to hold their own in the increased competition.

- New computers, new software, programming, employee training and information campaigns will account for most of the investment to modernize their systems in order to keep up with the increasingly rapid technical developments in the financial sector (http://www.dip-badajoz.es/eurolocal /entxt/services/quest/7.htm).
- The Single Market competition will enforce the banks to widen their offer by including more comprehensive services and innovative products, often based on modern information technology, in order to meet clients' demands and to remain competitive within the EU banking market.
- The common monetary framework and the liberalized capital flows will be more beneficial in the long run as they create more severe competition from the date of accession. On the one hand, diminishing sovereign risk may raise inflows into the local banking. On the other hand, the banks of North Cyprus will be in a better position to diversify assets geographically and they will benefit from their local knowledge. It seems to be unlikely that the local banks will target advanced EU markets, but it is possible that they will expand their market scope in other countries, where they will be able to benefit from the competition.
- As a result, the banks will struggle for larger shares of the expanding market and for new customers which require both the expansion of the banking network and the perpetual innovation of banking.
- With mergers of the banks some people may loose their jobs. However this will be offset with opportunities in other sectors (http://www1.dogus.edu.tr/ dogustru/journal/sayi_6/M00079.pdf).

- There can be threat that strongly capitalized Greek-Cypriot Banks will dominate the banking sector in a unified state, however, due to the nature of the industry and the emphasis on personal relationships, it is believed that the Turkish-Cypriot banks will lose some business to the Greek-Cypriot banks (http://www1.dogus.edu.tr/dogustru/journal/cilt_4_sayi_2/M00097.pdf).

4. CONCLUSION AND RECOMMENDATIONS

In this study the following has been accomplished: the impact of globalization on banking sector has been figured out; the economy of TRNC, current position, importance, basic structural problems and the extent of globalization in the banking sector have been evaluated; additionally, possible impacts of globalization on the TRNC banking sector in the light of EU membership have been assessed. The main findings of the study can be summarized as follows:

In the past two decades, all over the world, banking was affected by globalization trend. Globalization of banking refers to integration of banking activities through national borders into world market. The trend brings advantages as economies of scale and scope, attracting foreign direct investment, product and service innovation, developing financial markets, establishing cross-border mergers, ability to become a member of international institutions like Bank for International Settlements and foreign global networks like SWIFT. There are also disadvantages as money laundering, product differentiation in international retail banking and ease of Internet banking scams resulting that operations may be easily confused with legitimate banks doing business on the Internet, posing a threat to consumers and legitimate banks alike.

In order to provide international regulatory cooperation and response to some negative effects of globalization several international institutions such as the Basel Committee on Banking Supervision, the BIS and the IMF were created.

According to the evaluation of the case study we have found that the TRNC banking sector is one of the main parts of the country's economy. The sector consists of 25 commercial and 21 offshore banks. As it can be seen from Table 3.1 and Table 3.18 the banking sector had 4.3% share in the GDP (9,180.1 million TL) and 2.6% share in the total employment in 2002.

Proactive strategies will become increasingly important for the TRNC banking sector as the financial sector recovers from the effects of the banking crisis and begins to channel funds into the real sector.

The banking crisis resulted in an initial reduction of total deposits in the banking sector, which then steadied in 2001 and began to rise again in 2002.

As can be seen from Table 3.20 the growth of loans has not kept up with the rate of inflation for the past three years. In real terms, there has been a reduction in total loans granted by the banks.

There are insufficienties in the banking sector, since having various structural problems such as excess liquidity; no ability to become a member to foreign global networks like SWIFT, Visa and Master Card; no existence of special commercial courts in TRNC to solve debt/credit side related lawsuits of banks.

The primary problem for banks today, is to channel funds into viable projects, under the prevailing economically stagnant environment.

The trend today is to separate the monetary control and banking supervision functions traditionally carried out by the central banks. In the United Kingdom (UK), banking supervision is now the responsibility of the Financial Services Authority (FSA) and in Turkey, banking supervision is the responsibility of the Banking Regulation and Supervision Board (BDDK), whereas previously in both these countries the central banks used to have banking supervision departments. Should TRNC follow this example? Considering the size of the banking sector and the minimum function of the TRNC Central Bank, with regard to monetary control, the authors believe that banking supervision should remain in the hands of the TRNC Central Bank. This is especially important since the Central Bank has been granted autonomy from political control and now is independent to exercise its authority.

The most important finding of this study is that the effect of globalization on the TRNC banking sector is minimal. The local banks cannot provide full range of international banking activities; the banks' guarantorship is not accepted in countries other than Turkey; they cannot establish cross-border mergers; the financial institutions are not able to have access to international networks like SWIFT, with the result that international banking services become more expensive than SWIFT-using banks in other countries.

The extent of globalization in the TRNC banking sector is reflected in the following: integration of the TRNC international banking services to other countries' financial systems through correspondent banking; the local banks can provide transfers to any country and can accept transfers from any country; only one local bank – Turkish Bank Ltd. has subsidiaries in foreign countries, they are Turkish Bank A.Ş. in Turkey consisting of the Head Office with its 12 branches and Turkish Bank (UK) Ltd. in England consisting of the Head Office with its 3 branches; liberal capital accounting, no restrictions on capital inflows and capital outflows in regard to foreign countries; currently, there are 21 offshore banks in TRNC; at the end of 2003, 18,8% of the banking sector's total assets were in foreign banks; there are 6 branches of foreign commercial banks in Northern Cyprus. The amount of total assets of the foreign branches in TRNC at the end of 2003 was 820,657,067 million TL (Turkiye Garanti Bankası had not been established yet at the end of 2003) , equivalent to 28,3% over total assets of all commercial banks in TRNC.

Considering future opportunities for the Turkish-Cypriot banking sector to participate in globalization in full array and benefit from yields of this trend, the possible EU membership of TRNC is an appropriate alternative for this. If, TRNC, after possible solution in the island becomes a member of EU, political and economic isolation of North Cyprus automatically will be abolished. The State becoming an EU member automatically will also become a member of EMU. As a result, the EU membership of

TRNC will bring a lot of changes, challenges and opportunities for the sector. For example, the Turkish-Cypriot banks will be able to provide full range of international banking activities; the local financial institutions will have ability to act as guarantor in transactions with other countries, to establish cross-border mergers, to access international networks like SWIFT; the banking sector will be able to become a member of international institutions providing an important role in globalization of banking, such as the BIS.

"EURO" will be accepted as a medium of exchange, which will be a stable currency. With a stable currency interest rates bankruptcies will go down hence less debt for the banks. In other words, there will be lower losses for the banks. There will be no initial cost of accepting a local currency. The need to keep money in cash will be lowered. The intra-European currency risk will be eliminated. The sovereign risk will be diminished. There will be training staff and changing over their internal accounting and computer systems to the euro from the date of accession. There will be opened up new markets for banks, particularly in trading, asset management and investment banking activities. As the market size expands, the sector's profitability will rise and accumulations of equity will increase.

The Central Bank of TRNC will become also a participant in the ESCB. Although the Central Bank at the current moment provides limited monetary policy, the membership in the ESCB means for the Central Bank that it will lose out its right to formulate and conduct its monetary policy as the single monetary policy within EMU is conducted by the ECB. The TRNC national payment system will be linked to the

TARGET system from the date of full accession. The controls provided by the ESCB will make sure banks are fundamentally financially sound. There will be more prudential control on providing loans and accepting deposits for the Turkish-Cypriot banks.

The inflation accounting will be excluded.

There will be lower interest rates both of credits and deposits. Businesses will be doing better with low and stable interest rates and with a healthy small business sector.

The credibility and stability of the banking sector will be increased, because of gradual implementation of the EU banking laws' basic principles, prudential regulations and provisions. The more credible and stable financial institutions of North Cyprus considering a stable currency, elimination of exchange rate risk, optimum capital allocation, increased transparency and comparability of prices of banking services, provision of a large range of products, a broad range of maturities, a high level of liquidity and low transaction costs will attract an enormous amount of international custom and will attract both international investors and borrowers.

The concentration of transactions on a currency will be fostered by economies of scale.

The demand for "Euro" funds will increase.

There will be also tougher competition, new operational and credit risks. The introduction of the euro and increased competition will encourage domestic and cross-border banking consolidations in the form of mergers and acquisitions in order to strengthen position of the financial institutions of North Cyprus to hold their own in the increased competition. The Single Market competition will also enforce the banks to widen their offer by including more comprehensive services and innovative products, often based on modern information technology, in order to meet clients' demands and to remain competitive within the EU banking market.

The common monetary framework and the liberalized capital flows will be more beneficial in the long run as they create more severe competition from the date of accession. On the one hand, diminishing sovereign risk may raise inflows into the local banking. On the other hand, the banks of North Cyprus will be in a better position to diversify assets geographically and they will benefit from their local knowledge. It seems to be unlikely that the local banks will target advanced EU markets, but it is possible that they will expand their market scope in other countries, where they will be able to benefit from the competition.

There can be threat that strongly capitalized Greek-Cypriot Banks will dominate the banking sector in a unified state, however, due to the nature of the industry and the emphasis on personal relationships, it is believed that the Turkish-Cypriot banks will lose some business to the Greek-Cypriot banks.

It is very important for the Northern Cyprus banking sector to solve the current problems and make the necessary preparations for succeeding in dealing with challenges of globalization and sharing the benefits of this trend in the future possible prospects such as the EU membership of TRNC.

The following actions are recommended for creating a strong banking sector competitive enough, to be able to cope with a new market environment conditions and share the benefits of globalization in the light of EU membership:

- The 100% guarantee of deposits places a considerable burden on the state and to the banks insured, due to the high (1% of deposits) premium, it also creates an environment where depositors are not induced to punish risk-taking institutions, through the withdrawal of deposits; therefore, the 100% guarantee should be phased out and the insurance premium reduced.
- Taxes and levies on loans should be removed, in order to bring down the cost of borrowing money.
- Credit skills of the banking institutions should be enhanced by introducing proactive credit skill-building measures.
- The flow of savings should be utilized and realized.
- There should be legalized arrangements regarding establishing of special commercial courts that would provide fast and just solutions for debt/credit lawsuits of banks.
- There should be legalized arrangements regarding the establishment of financial institutions like "leasing" and "factoring".
- An interbank money market should be activated.
- The TRNC Stock Exchange is not activated despite being opened; to make the Stock Exchange function effectively laws should be prepared especially to encourage the family firms to open themselves to the public; the attempts for the development of the TRNC Stock Exchange which have begun in the past in cooperation with the Istanbul Stock Exchange should be completed and

arrangements for relations with the external world through the Istanbul Stock Exchange should be provided.

- The banks with unsound assets and infrastructure, resulted from the crisis, should not be given banking permitions demanded from overseas for transitional period; otherwise, these banks will not be able to compete and will die.
- The local banks should increase their capitals or establish mergers or leave the market.
- EU requires 5,000,000 EURO of capital for establishing a bank in a euro-zone; even if the local banks reach this level of capital, it is not sufficient to compete with European banks, so the level to be aimed here should be higher.
- North Cyprus banking supervision and legislation have to be completely synchronized to EU standards.
- Further training and education of banking staff in the local banks should be provided.
- A legacy of bad debts and a lack of experience in credit risk assessment should be coped with.
- There should be innovation in the technical tools and the infrastructure.
- The new operational risk measurement will likely require some sort of modification of current management information systems of the banks.
- In the preparation period of the banking sector to EU market conditions permition to foreign banks to establish their branches in North Cyprus should not be given.

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