

ECONOMIC INTERDEPENDENCE IN CYPRUS

CURRENT ASSESSMENT AND PROSPECTS
FOR THE FUTURE

MAIN FINDINGS AND RECOMMENDATIONS

JUNE 2011



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TABLE OF CONTENTS

PREFACE	3
EXECUTIVE SUMMARY	4
ECONOMIC INTERDEPENDENCE IN CYPRUS.....	7
INTRODUCTION	7
CYPRUS ECONOMY	7
MAIN FINDINGS	9
Scenario 1: Findings, Challenges, Opportunities	9
Scenario 2: Findings, Challenges, Opportunities	14
MAIN RECOMMENDATIONS.....	19
Recommendations (Scenario 1)	19
Post Settlement Recommendations (Solution Scenario 2)	23
CONCLUSIONS	28
ENCLOSURE 1: SECTORAL RECOMMENDATIONS (SCENARIO 1)	29

Table 1: Estimated Expenditure Across the Green Line by Year

Graph 1: TCC, GCC and Cyprus GNP, GDP and Imports and Exports of Goods in 2008

Graph 2: Assumed Green Line Movement 2003

Graph 3: Annual Development of Green Line Trade (€)

Graph 4: Estimated Expenditure Across Green Line by Year (€mln)

PREFACE

The “Economic Interdependence” Project is implemented by the Cyprus Chamber of Commerce and Industry and the Turkish Cypriot Chamber of Commerce with funding from UNDP ACT, which is supported by USAID. The objective of this stage of the project (Study A) is to examine the current state of economic interdependence between the Greek Cypriot and Turkish Cypriot communities and make recommendations for the future under both the present conditions on the island defined as a “delayed solution” (Scenario 1), and in the event of a solution, that is a Cyprus Settlement involving a comprehensive agreement to reunify the island (Scenario 2). A second report (Study B) will follow, which will utilize the findings of Study A, but will focus on the development of a framework for joint economic planning aiming at facilitating competitiveness and economic growth. For the purposes of the study Scenario 1 has been assumed as the present situation on the island without fundamental changes, and Scenario 2 as a Cyprus solution as defined by the Peace Economics Consortium.

Project implementation was awarded to the Peace Economics Consortium (PEC), which has undertaken the study in close cooperation with the Cyprus Chamber of Commerce and Industry and the Turkish Cypriot Chamber of Commerce.

The Peace Economics Consortium (PEC) members are EMS Economic Management Ltd and the NorthCyprusInternationalPeaceResearchCenter, whereas the PEC Team consists of Dr. Erdal Guryay, Mr. Costas Apostolides, Dr. Fehiman Eminer, Dr. Constantinos I. Papadopoulos, Dr. Okan Veli Safakli, Mr. Louis M. Loizou, Mr. Ahmet Ozyigit and Dr. Alexander Apostolides.

This study refers to the current state of interdependence and competitiveness and has been prepared by the PEACE Economics Consortium, in accordance with the terms of reference of the Economics Interdependence Project for Report “A”. According to the Terms of Reference Report “A” is entitled “Current economic Interdependence between the Greek-Cypriot and the Turkish-Cypriot Communities assessed and recommendations for reinforced economic convergence”. It is a requirement that Report “A” should present an assessment of the current state of economic interdependence and recommendations for the future, based on two scenarios, the solution of the Cyprus problem, and a delayed solution.

Report “A” consists of this abridged version presenting the Main Findings and 6 volumes as follows:

- Volume I: Comprehensive Assessment of Economic Interdependence (Scenario 1 and 2).
- Volume II: Current State of Interdependence and Competitiveness (Scenario 1).
- Volume III: Current State of Interdependence by Economic Sector (Scenario 1).
- Volume IV: Current State of Economic Interdependence: Survey and Workshop Results (Scen.1).
- Volume V: Current State of Interdependence regarding EU Harmonization, Environment and Sustainability (Scenario 1 and 2).
- Volume VI: Economic Interdependence after a Cyprus Settlement (Scenario 2)

For the full text, assumptions for Scenario 2 and full bibliography refer to www.cpnet.net

EXECUTIVE SUMMARY

1. Report 'A' on economic interdependence concludes that economic interaction across the Green Line is more significant than previously thought and was estimated at about €300m in 2009, that the present political situation imposes constraints on the Island's economy, and that both the Greek Cypriot Community (GCC) and Turkish Cypriot Community (TCC) have been negatively affected by the international economic crisis. It was found that a Cyprus settlement will result in the removal of the political constraints to economic development, and that the implementation of a settlement will lead to economic recovery.
2. The report entitled "Present State of Economic Interdependence in Cyprus and Recommendations for the Future" has been undertaken by the Peace Economic Consortium and prepared within the context of the "Economic Interdependence Project", implemented by the Cyprus Chamber of Commerce and Industry and the Turkish Cypriot Chamber of Commerce, and supported by the United Nations Development Programme – Action for Cooperation and Trust and USAID. The basic aim of this Program is to promote economic interdependence between the GCC and TCC, create mutual interest in economic cooperation, and prepare the two economies for a Cyprus settlement.
3. Economic Interdependence grew to €311m in 2008, and fell slightly to €301m in 2009. The main findings relating to economic interdependence were the following:
 - (1) Movement across the Green Line and the EU Green Line Regulations, have both resulted in the growth of consumer expenditure, trade and Turkish Cypriot employment since April 2003 when crossing the Green Line became possible.
 - (2) These factors, plus social insurance payments and health services, have benefited the Turkish Cypriot Community by an estimated €185 million in 2008 and €192 million in 2009.
 - (3) Movement across the Green Line by Turkish Cypriots, were estimated to have benefited the Greek Cypriot Community by €126 million in 2008 and €109 million in 2009.
 - (4) The most important factor in economic interdependence is movement of people across the Green Line which accounts for 75% of the total intra-island expenditures, the others being Green Line trade, TCC employment and social insurance and health service provision. In 2008 3.7million people crossed the Green Line, but this fell to 3.2m in 2009.
 - (5) A survey undertaken found that on average Turkish Cypriot expenditure per visit across the Green Line is higher at €70 per visit, while for Greek Cypriots this was €50 per visit.
 - (6) Turkish Cypriots registered as employed south of the Green Line in 2008 were 2,800, but this fell to 2,460 in 2009, owing to recession in construction.
 - (7) The contraction in the TCC economy began in 2008 and turned into depression in 2009, and has been deeper, while south of the Green Line the recession occurred in 2009 and has reduced TC employment and Green Line movement, thereby reducing TCC expenditure south of the Green Line.
 - (8) Crossing the Green Line has been made easier by the seven crossing points, but these still impose a cost in time, fuel and insurance (€68 for GC's and €48 for TC's per visit by car).
 - (9) An impediment to economic interdependence is the psychological problem which has its source in the experiences of the past, and the failure to reach a Cyprus settlement.
4. At the macro-economic level the island of Cyprus in 2008 had an estimated population of 1,071,300 and a labour force of 470,300 resulting in an employment ratio (activity rate) of 44% and 5.2% unemployment. Island wide GDP was €19.9 billion, of which the TCC proportion was 13%. Overall per capita income was €18,588, but TCC per capita was €9,970 (54%). This lower TCC figure arises from a lower activity rate and from lower productivity levels.
5. The present political situation in Cyprus imposes constraints and costs on the economy including transportation costs, trading procedures, underutilization of resources and other distortions. Furthermore it gives rise to restrictions on economic investment and activity and lost opportunities, and additional costs (assistance to displaced persons, high military expenditure). The TCC

economy is much more affected by such constraints, in large part due to its smaller size and the political conditions on the island.

6. The Economic Interdependence Project will also include a Report 'B' aiming at presenting a framework for a joint economic strategy after a Cyprus Settlement. In this respect a Cyprus settlement will result in the following:
 - (i) The removal of the constraints arising from the present political situation to the benefit of the whole population.
 - (ii) Improvements in transport and communications and reductions in costs.
 - (iii) Demilitarization will reduce defence costs and allow earlier male employment.
 - (iv) The TCC will be fully integrated into the EU and the world economy.
 - (v) Economic interdependence and intra-island trade will grow enormously.
 - (vi) Psychological problems regarding interdependence will be greatly reduced.
 - (vii) The implementation of the Cyprus settlement will create new demand for construction, household goods, manufacturing inputs, transport and other sectors.
 - (viii) Unemployment will be reduced by the implementation of the solution and new opportunities.
 - (ix) Cyprus will be strengthened as an international business and shipping centre.
 - (x) Both the GCC and the TCC will benefit from smooth implementation of a solution.

7. The present financial crisis has affected the capability of the economy to finance a Cyprus settlement, and therefore it is essential that the costs and benefits of a solution be estimated, and that financial assistance is provided to facilitate a Cyprus settlement. It is recommended that the financial requirements of a solution should be assessed in order to submit proposals for assistance from the EU and other sponsors, and ensure flexibility within the EU Stability Pact. In Report 'B' proposals will be made relating to the phasing of solution costs, fiscal management, and the requirements for EU and donor funding.

8. The recommendations in the report regarding intra-island trade and interdependence under the present conditions include the following:
 - (1) The leaders of the GCC and TCC should set out their policies on economic interdependence and should actively support intra-island trade and economic activity. Furthermore a publicity campaign should be undertaken to encourage intra-island economic cooperation and officials should be trained in such a policy.
 - (2) Green Line Trade in goods should be encouraged.
 - (3) The number of crossing points across the Green Line should be increased to facilitate movement and reduce travel, time and monetary costs of crossing over.
 - (4) The TCC should be encouraged to implement more urgently its EU harmonization programme, and extend the programme to cover all measures affecting intra-island trade and particularly quality and health standards.
 - (5) Cooperation between professional associations across the Green Line and greater involvement of the All Cyprus Trade Union Forum, would extend economic cooperation.
 - (6) The confidence building measures relating to the environment, cultural affairs, health, crisis management, crime and criminal matters should be implemented and finance provided.
 - (7) The Technical Committees set up under the Cyprus Talks should be reactivated on the lines of the Joint Unit on Criminal Matters and the Technical Committee for the Cultural Heritage. Additional committees on intra-island trade and cooperation, and on agriculture, veterinary services, forestry and others, should be established.
 - (8) An initiative to facilitate mobile telephone roaming facilities in Cyprus should be undertaken assisting those crossing the Green Line.

(9) A cooperation mechanism for planning and ensuring sustainable development in the event of a Cyprus settlement should be established.

(10) The CCCI and TCC should be supported with the aim of developing economic interdependence and cooperation further, and preparing for a Cyprus Settlement.

9. The study concludes that economic interdependence is developing. There is evidence that the two markets affect each other to some extent, and that in terms of GDP the positive impact is mainly on the wholesale/retail sector, restaurants and tourism. Such interdependence improves competitiveness and helps businesses to prepare for a Cyprus settlement. Work is continuing on the second stage of the study, which aims at examining the economic development of the island after a Cyprus settlement and setting out a framework for a joint economic development plan.

ECONOMIC INTERDEPENDENCE IN CYPRUS

INTRODUCTION

- (1) The basic aim of the Economic Interdependence Project is to promote economic Interdependence between the Greek Cypriot Community (GCC) and Turkish Cypriot Community (TCC) in Cyprus. Within this context Report 'A' presents the assessment of current economic interdependence between the two communities and recommendations for reinforced economic convergence under two Scenarios:
Scenario 1: A delayed solution to the Cyprus problem (defined as a continuation of the present situation) is the object of this report (Report 'A').
Scenario 2: A Cyprus settlement, taking into consideration the development strategy and the preparation for a joint economic plan, which are the aims of Report 'B'.
- (2) Report 'A' consists of abridged version presenting the Main Findings and 6 volumes as follows:
Volume I: Comprehensive Assessment of Economic Interdependence (Scenario 1 and 2).
Volume II: Current State of Interdependence and Competitiveness (Scenario 1).
Volume III: Current State of Interdependence by Economic Sector (Scenario 1 and 2).
Volume IV: Current State of Economic Interdependence: Survey and Workshop Results (Scenario 1).
Volume V: Current State of Interdependence regarding EU Harmonization, Environment and Sustainability (Scenario 1 and 2).
Volume VI: Economic Interdependence After a Cyprus Settlement (Scenario 2).
- (3) The abridged version presenting the Main Findings is based on the all six volumes of Report 'A', and aims at presenting the results of the study in condensed form.
- (4) Approach: The report defines economic interdependence as the total economic interactions between the two communities, including trade and services, employment, social transfers and welfare gains (i.e. shopping, choice). Economic interdependence is also considered with the associated concepts of economic convergence, EU harmonization, competitiveness, and psychological factors.

CYPRUS ECONOMY

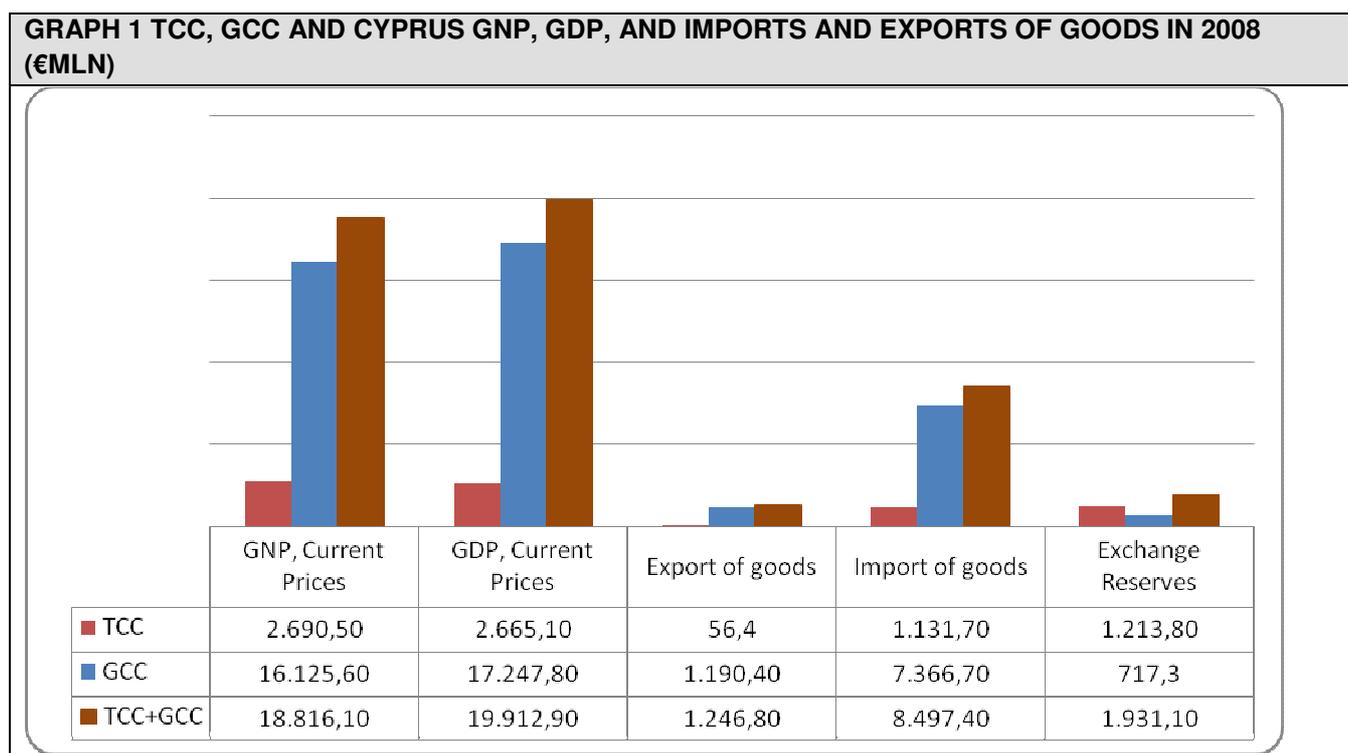
- (1) In view of the political situation in Cyprus, there are a number of constraints on economic development which affect the island as a whole, the GCC and the TCC. These constraints arise from UN resolutions, judgments and opinions by the European Court of Justice and UK High Court and the European Court of Human Rights. They create costs for all the parties involved, but considerably more difficulties for the TCC economy, and have resulted in its lack of integration in the EU and world economy, as well as constraints in intra-island economic interaction. Owing to the small size of the TCC economy, the impact of these constraints is increased by such factors as the lack of scale economies, and problems of macro-economic management. Needless to mention that the current Global economic crisis has worsened the impact of such constraints.
- (2) It is assumed under Scenario 1 of Study "A" of the Economic Interdependence Project that the present *status quo* regarding the present situation is maintained, and that under Scenario 2 and Study "B" which assume a Cyprus solution, all these constraints will be removed by an agreed settlement and the reunification of the island. This is also assumed in Volume VI of this Report¹.

¹ Report 'B' is based on the assumption of a "solution", and all constraints are assumed to be removed.

(3) The Cyprus Economy as it was in 2008 is shown below. The basic features of the economy as a whole were as follows:

• Population	1,071,300,	GCC 74.4%,	TCC 25.6%
• Employment	470,300,	4GCC 80.6%	TCC 19.4%
• Activity rate	43.9%,	GCC 47.5%,	TCC 33.2%
• Unemployment Rate	5.2%,	GCC 3.8%,	TCC 10.8%
• GDP	€19.913mln,	GCC 87%,	TCC 13%
• GDP per capita	€18,588,	GCC 116%,	TCC 52%
• Productivity	€42,341,	GCC €45,341,	TCC €29,215
• Exports	€1,247mln,	GCC €1,190mln,	TCC €57mln
• Current Account Deficit	-16.6%,	GCC -18%,	TCC -10%
• Inflation	6%,	GCC 4.7%,	TCC 14.5%
• Exchange reserves	€1,931mln,	GCC €717mln,	TCC €1214

(4) The population of the TCC forms 26% of that of Cyprus, but GDP is only 13%. There is a clear disparity between the GCC and TCC economies with TCC unemployment accounting for 41% of the total, inflation being three times higher, exports less than 5%, and the TCC activity rate only 33%. But the TCC exchange reserves are higher than GCC, because the Eurozone has the effect of the whole currency being an exchange reserve. TCC per capita income was 52% of that of the island, but productivity was relatively higher at 69% (Graph 1).



(5) The Cyprus economy has been in recession, following a period of rapid economic growth from 2002 to 2007, the TCC entered a recession in 2008 and the GCC in 2009. Growth of the GCC economy (GDP) was at a real average rate of 3.7% per year from 2004 to 2008, and the TCC economy grew at 6% over the period. However, the TCC economy was in recession in 2008 and GDP at constant prices fell by -2.9%. In 2009 both economies were in recession with the TCC declining by -6.1% in real terms² and the GCC economy falling by -1.7%. The situation in 2010 is still uncertain, but it appears that the situation has stabilized in both economies. The European Commission "2010 Autumn Forecast" anticipated an increase at 0.5% for the GCC economy in 2010. In the TCC the situation is very serious with high unemployment and public sector finances facing exceptional difficulties, while in the GCC the budget situation changed from a surplus to a deficit situation, and

²Considered serious enough to be a depression.

unemployment remains historically high, but at moderate levels in relation to most EU member states.

- (6) Within this context the cost of a Cyprus Settlement would be very difficult to finance from local financial resources. On the other hand, there is spare capacity in the economy to undertake reconstruction and resettlement, and the investments required to implement a solution will promote economic recovery and increase local revenues. A settlement will result in rapid economic recovery for the benefit of both communities.
- (7) One problem is that when Cyprus joined the Eurozone, no derogation was obtained in the event of a Cyprus Settlement from EU Maastricht criteria, the European Central Bank and the EU Stability Pact. Furthermore, the EU has no contingency plans for contributing funds to facilitate a Cyprus Settlement. A united Cyprus would, have to increase public expenditure enormously to finance the resettlement and integration of the infrastructure, and therefore create very large public finance deficits, outside the bounds of EU and ECB criteria. As a consequence the EU must provide substantive assistance to overcome the expected serious fiscal difficulties during the implementation stage of the agreed solution. In Report 'B' this problem will be addressed by the phasing of solution related expenditures to make the fiscal requirements more manageable, provision for private sector and individual resources, and estimation of the requirements from EU funds and donor countries and international institutions.

MAIN FINDINGS

The main findings relate to the results of surveys and research, the identification of challenges and opportunities, and are presented separately for Scenarios 1 and 2.

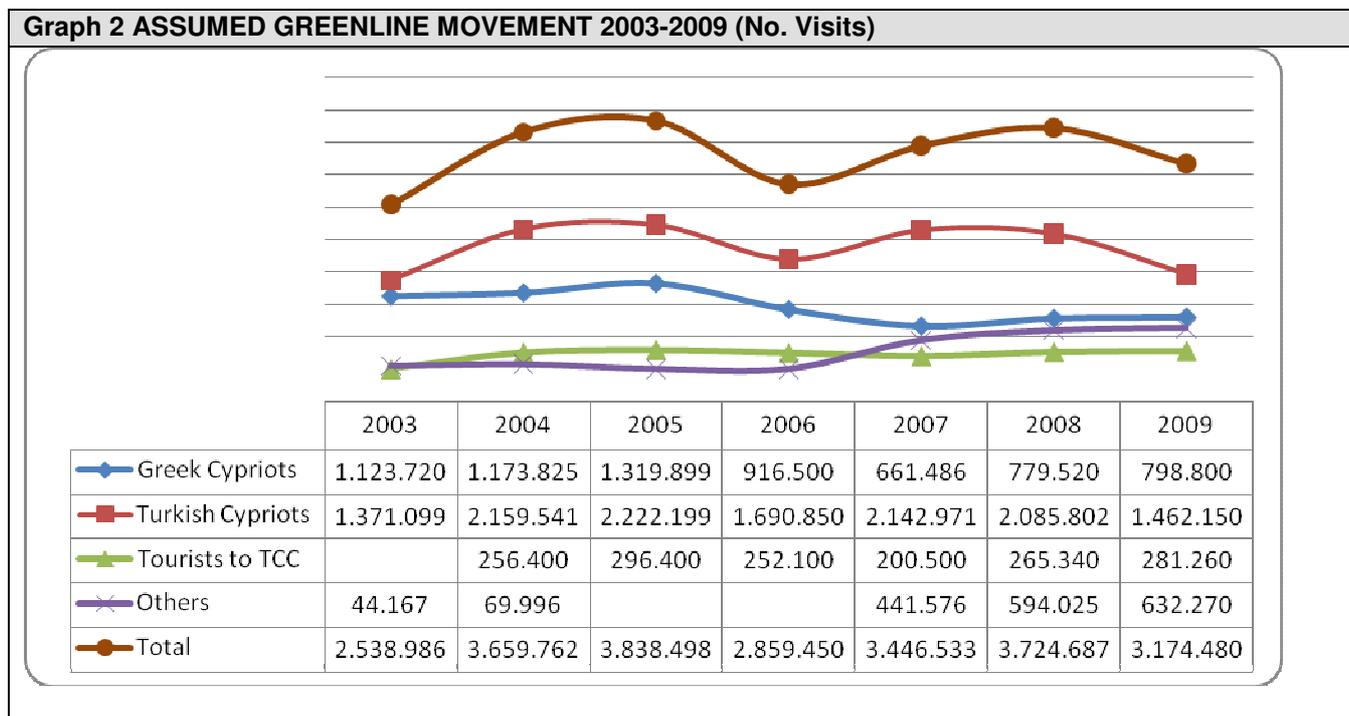
SCENARIO 1: FINDINGS, CHALLENGES, OPPORTUNITIES

Findings

In 2008 and 2009 more than three million crossings over the Green Line were registered in both directions, and over €300m in expenditure, income and transfers crossed the Green Line to the benefit of both communities. As a result both communities in Cyprus benefited from the welfare gains arising from greater variety and choice in goods and services, price and quality differentials, trade and employment opportunities.

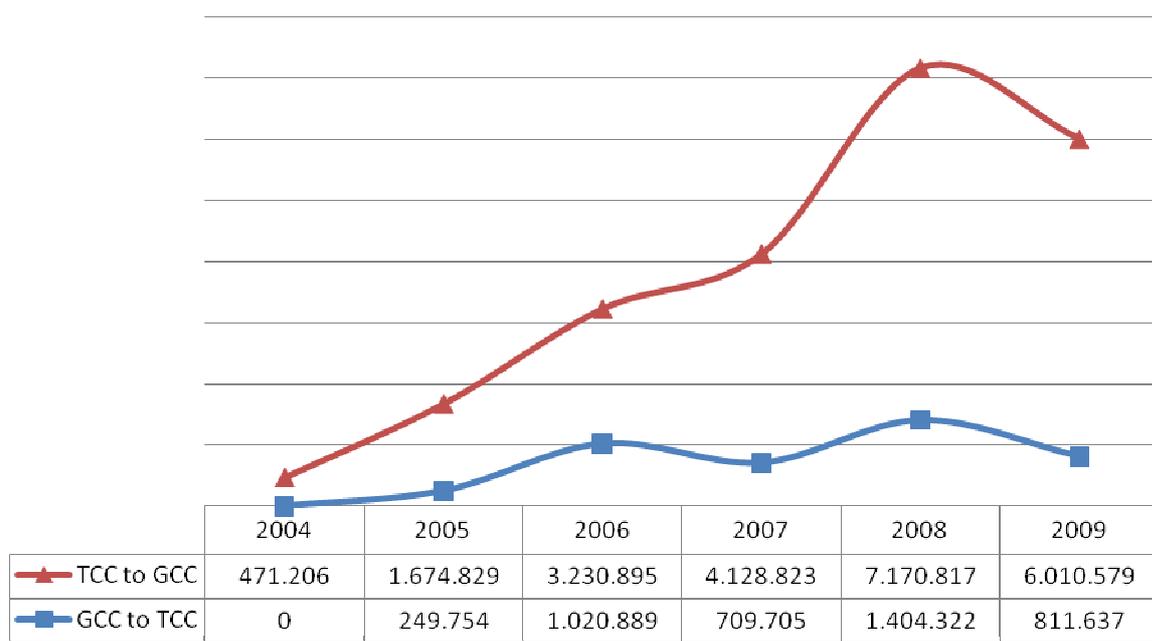
- (1) The main factor in economic interdependence is the ability of people to cross the Green Line for recreation, religious visits, and visits to home village/town, for personal reasons, employment or shopping, all of which accounted for €226 (75%) of interdependence expenditure in 2009. Trade is an important but relatively small part of overall transactions and transfers, accounting for almost €7m of interdependence transactions, or 2% of the total.
- (2) Movement across the Green Line increased from 2.5 million in 2003, peaked at 3.8 million in 2005, declined in 2006, and then recovered with the opening of the Ledra Street crossing point. In 2009 the total number of crossings fell to 3.2 million in large part because of the recession, which affected TCC employment south of the Green Line. There are more TC crossings, in part due to employment in the GCC economy, but GC crossings showed a modest increase. In 2009 46% of crossings were by TC's, 25% by GC's, 9% by tourists visiting TCC, and 20% by third country nationals living in Cyprus (Graph 2).
- (3) The present cost of crossing the Green Line in terms of time and cash costs is quite high (estimated at an average €68 for GCs and €48 for TCs per vehicle with 2 passengers per visit). Consequently the opening of new crossing points in addition to the present seven will reduce costs (i.e. mainly trip costs in terms of diversion time) and encourage Green Line crossings and interdependence transactions. This "surcharge" negatively affects trade and services, and reduces the crossings undertaken.

- (4) The present economic crisis is negatively affecting movement across the Green Line, TC employment in the GCC economy and Green Line trade. It is especially severe within the TCC community where the recession began earlier in 2008, while the GCC economy went into recession in 2009.
- (5) About 10% of tourists entering through Larnaca/ Larnaka Airport visit the TCC, of which roughly three-quarters for a day visit, the rest stay on up to six days or more. Average expenditure of tourists to TCC was very high at €162 per visit in 2007.



- (6) It is assumed that TC employment in the GCC economy conforms to that of registered TC's in the GCC social insurance system, despite the fact that the project survey found that 22% of TC's crossing the Green Line for employment were not registered. TC's registered for work peaked at 2,800 in 2008 but fell to 2,460 in 2009. There is good cooperation by GCC and TCC trade unions on TC employment. It is estimated that TC labour accounted for 35% of TC crossings
- (7) Green Line trade has increased rapidly for TCC sales south of the Green Line from August 2004, by an average of 37% a year. In 2008 TCC Green Line Trade reached €7mIn, but fell in 2009 by 17%. In 2009 the GCC market with about 12% of all outgoing trade in 2009, was the TCC's second largest trade market (sales surpassed those to UK). GCC sales to TCC have made less progress and are hampered by VAT regulations, and administrative difficulties, and are erratic. In 2010 TCC sales to the GCC through Green Line Trade remained at the 2009 level at around €6mIn, while GCC sales increased by 34% to just over €1mIn.
- (8) The surveys undertaken under the project confirmed previous findings that showed that in both communities there are significant psychological constraints, which restrict some business people and some consumers from participation in Green Line crossings and trade. These psychological factors are partly based on perceptions of the modern history of Cyprus, but also on confusion as to what is the official policy of the political leadership of both communities on Green Line trade and economic interdependence. There is also some resistance to engage in Green Line trade because of concern of some firms about increased competition. Nevertheless, there has been a tendency for greater interest in Green Line trade by companies that have not yet participated in such trade, and an interest in cooperation between GCC and TCC firms.

GRAPH 3 ANNUAL DEVELOPMENT OF GREEN LINE TRADE (€)

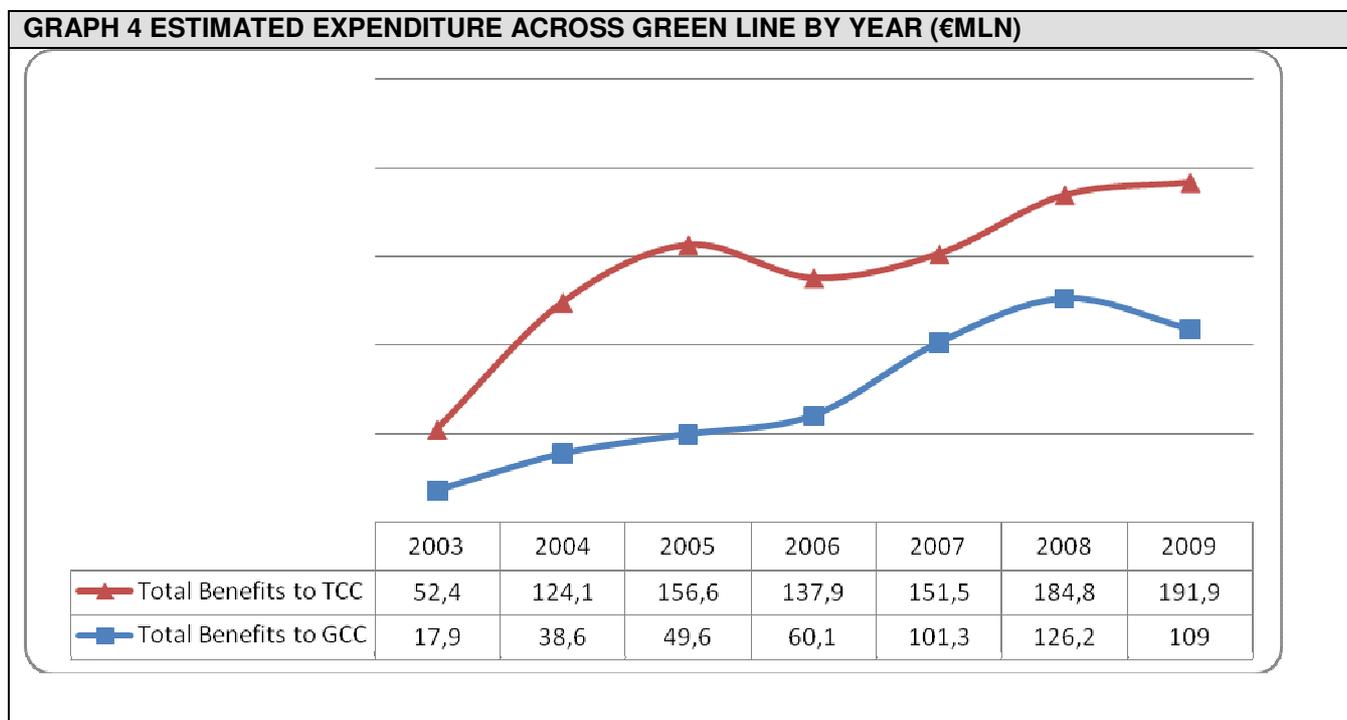


- (9) Pension Payments to the TCC from the social insurance rose to €19.6m in 2009, while TC's registered 19,665 visits to GCC public sector hospitals in 2009.
- (10) The project crossing survey found that on average TCs crossing the Green Line in late 2009 spent €70 per person per visit, while GCs going in the opposite direction spent €50 per visit.
- (11) It is calculated that funds moving from the GCC to TCC peaked at €192m in 2009, rising from €185m in 2008 and €152m in 2007. Funds moving from TCC to GCC peaked at €126m in 2008, but fell back to €109m in 2009. Details of the estimates are shown in Table 1 below, and the trends are shown by Graph 4.
- (12) The funds moving from GCC to TCC in 2009 are estimated in expenditure terms at €192m or to constitute 7.5% of TCC GDP, but the more correct comparison is the GDP effect (value added) estimated at €150m or 5.9% of TCC GDP.³ The effect of €109 m in TCC expenditure in relation to the GCC GDP was only 0.4%. For the purposes of these estimates the public health services provided by the GCC to the TCC (about €7m) are included (even though they are not a monetary transfer) because they represent a real cost and constitute a welfare gain for the TCC.
- (13) The main TCC economic sectors benefiting from financial flows from GCC across the Green Line were:
- | | |
|----------------------------|------|
| Wholesale / Retail Sector: | €63m |
| Hotels / Restaurants: | €46m |
| Health / Social: | €7m |
- (14) From the TCC to GCC the main sectors benefiting from expenditure were:
- | | |
|--------------------------|-------------------|
| Wholesale / Retail Trade | €63m ⁴ |
| Hotels/Restaurants | €36m |
| Education | €4m |

³The value added (GDP) effect is estimated by subtracting intermediate inputs from expenditure which is assumed to approximate to Gross Output.

⁴By coincidence the benefits to the Wholesale and Retail Sectors of both the GCC and TCC through sales are approximately equal at around €63 mln.

(15) There are indications that in some markets there is a degree of integration across the Green Line. This appears to be the case in vegetable products which are sensitive to price differentials across the Green Line, while changes in VAT by the TCC seem to be addressed with the aim of maintaining competitiveness in retail prices in the TCC. It also appears that price differentials in retail markets are also increasingly compared, and affect consumer spending habits.



(16) Economic interdependence under Scenario 1 does not appear to have a negative impact on gender issues. In terms of Green Line crossings, both males and females cross over for visits to sites, the religious heritage and the original homes of displaced. These tend to be family visits. For recreation, visits to sites and restaurants again both genders participate. For shopping, females predominate in crossings. Differentiation occurs with TC employment south of the Green Line where males predominate because the majority are employed in construction. In nightlife and casinos males predominate. In general the problem of TC employment affects graduates over the issue of recognition of qualifications, and those who do not speak Greek (a requirement in retail trade, office services, and many professions). These factors affect both males and females, but are likely to be more restrictive for females. Overall, with 35% of TC crossings being due to employment, this affects the gender balance.

TABLE 1							
ECONOMIC INTERDEPENDENCE: ESTIMATED EXPENDITURE ACROSS GREEN LINE BY YEAR (€mln)							
BENEFITS TO TCC	2003	2004	2005	2006	2007	2008	2009
MOVEMENT							
GCs	18.9	31.2	47.9	36.3	28.5	37.1	39.4
Tourists	n.a.	36.4	44.8	36.0	32.5	43.1	45.6
Others ⁵	0.7	1.9	n.a.	n.a.	19.0	27.6	31.6
Car Insurance	1.0	1.4	1.5	1.1	1.5	1.2	1.4
Sub-Total	20.6	70.9	94.1	73.4	81.5	109.0	118.0
Labour Income	13.2	31.1	39.7	39.7	42.9	45.4	41.3
Green Line Trade	n.a.	0.5	1.3	3.2	4.2	7.2	6.0
TC Pensions	16.1	16.5	17.2	17.6	18.1	18.8	19.6
Public health	2.5	5.1	4.3	4.0	4.8	4.4	7.0
Sub-total	31.8	53.2	62.5	64.5	70.0	75.8	73.9
TOTAL	52.4	124.1	156.6	137.9	151.5	184.8	191.9
BENEFITS TO GCC	2003	2004	2005	2006	2007	2008	2009
MOVEMENT							
TCs	17.3	36.5	47.1	56.5	97.7	120.6	102.4
Car Insurance	0.5	1.3	1.4	1.5	1.6	1.8	2.1
Sub-Total	17.9	37.8	48.5	58.0	99.3	122.4	104.5
Green Line Trade	0.0	0.0	0.2	1.0	0.7	1.4	0.8
Private Education	n.a.	0.8	0.9	1.1	1.3	2.4	3.7
TOTAL	17.9	38.6	49.6	60.1	101.3	126.2	109.0

Challenges

The major challenges for the further development of economic interdependence under Scenario 1 are as follows:

- (1) To improve the welfare of the GCC and TCC by providing them with more choice in the variety, quality and price of goods and services through cross Green Line business cooperation and consumer cross overs.
- (2) To overcome the psychological reservations of some business managers and sections of the public, to cross the Green Line and participate in trade and services.
- (3) To deal with the problems faced in Green Line trade by simplifying VAT regulations and establishing a level playing field.
- (4) To add additional crossing points to make access across the Green Line easier and less costly in terms of time and money.
- (5) To stimulate cooperation among professional associations (accountants, lawyers, doctors).
- (6) To place goods from the other community in supermarkets and large stores, and increase Green Line trade.
- (7) To achieve an increase in tourists to Cyprus through the promotion of holidays involving appropriate accommodation on both sides of Green Line.
- (8) To achieve GCC/TCC cooperation on exports to Middle East, Central Asia and other countries.
- (9) To extend cooperation on trade with Turkey on the basis of the EU-Turkey Customs Union, for both imports and exports.
- (10) Green Line trade should be encouraged.
- (11) To achieve an increase in trade through the harmonization of product standards, and meeting EU health and environmental standards.
- (12) Achieve progress in the interrelationship of markets across the Green Line.
- (13) To facilitate TC employment south of the Green Line, through examination of the problems (recognition of diplomas, knowledge of English and Greek, registration for employment etc).
- (14) To encourage more gender balance in TC employment south of Green Line
- (15) To deal with the problem of access to the GC media by TC enterprises..

⁵ The term "others" refers to EU citizens (other than Cypriots) and third country residents of Cyprus.

Opportunities

The following opportunities for the development of economic interdependence under Scenario 1 have been identified:

- (i) The potential for increasing Green Line crossings and thereby expenditure on goods, restaurants and recreation.
- (ii) Cooperation on EU projects, particularly in training, harmonization and product standards, thereby increasing the potential for interdependence.
- (iii) The availability of the much larger GCC market for TCC goods and services, and the opportunities for scale economies.
- (iv) The potential for cooperation on the marketing of dual holidays (in appropriate accommodation) and tours by tourists on both sides of the Green Line.
- (v) The establishment of cooperation agreements and joint ventures between GC and TC companies.
- (vi) The potential for an increase in Green Line trade of GCC goods to the TCC if VAT and other procedures were to be simplified on the principle of the “level playing field”.
- (vii) Exploitation of the opportunities offered by the EU-Turkey Customs Union through GC/TC cooperation (exports and imports to GCC).
- (viii) The opening up of new export markets through GC/TC cooperation in Middle East and Central Asia.
- (ix) Cooperation in various areas including recycling materials, franchising and intra-island transport.

SCENARIO 2: FINDINGS, CHALLENGES, OPPORTUNITIES

Findings

- (1) A Cyprus settlement is expected to transform the economy of the island, and be an “engine for growth” and thereby improve the situation for the whole economy. The implementation of a solution would in itself help to generate progress in the economy, by changing the prospects for the economy, attracting foreign and local investment and developing Cyprus further as a business centre. The main effects will be as follows:
 - (i) The constraints mentioned in Section 2 above will be removed by a solution.
 - (ii) Transport and communications will be improved and costs reduced.
 - (iii) Demilitarization will reduce defence costs and enable young men to enter the labour force earlier.
 - (iv) The TCC will be fully integrated into the EU and the world economy.
 - (v) Interdependence and intra-island trade will grow enormously, and there will be gains through economies of scale, mainly for TCC enterprises.
 - (vi) Psychological problems regarding interdependence will be greatly reduced.
 - (vii) The implementation of the Cyprus settlement will create new demand for construction, household goods, manufacturing inputs, transport and other sectors stimulating economic growth.
 - (viii) Unemployment will be reduced initially by the investment and expenditures to implement the Cyprus settlement, and subsequently by the improvement in the attractiveness of Cyprus for foreign investment, international companies and tourism.
 - (ix) Cyprus will be strengthened as an international business centre.
 - (x) Cyprus will become more competitive as a whole because of the elimination of political constraints, improved access to markets, reduced costs in some areas (military, transport and other), and enhanced attractiveness for tourism and as a business centre.
 - (xi) Under Scenario 2 one of the key economic policies will be the convergence of the income and standard of living of the TCC with the GCC. The data suggests that this should take place through the following policies:
 - Increase of TCC activity rate (current share TCC 33% and GCC 48%).
 - Reduction of TCC unemployment, and creation of higher income job opportunities.
 - Improved economic interdependence (employment, business, trade).
 - Return to a growth economy initially by the investments required to implement a Cyprus settlement, and subsequently by improved competitiveness.
 - Provision of training opportunities for TCC.
 - Training of TCs in English, and Greek, and GCs in Turkish, to facilitate interdependence.

- (xii) Owing to a Cyprus settlement it should be possible to increase the provision of EU funds to Cyprus, transforming it from a net contributor to a net receiver of EU Funds, by meeting the criteria for additional cohesion funds and regional grants.
 - (xiii) The current economic recession has reduced the capability of both the GCC and TCC to finance a Cyprus solution. In view of the financial constraints imposed by the European Stability Pact, the European Central Bank and the new EU Economic Governance Policy it is important that the issue of financing a settlement be given priority to smooth the implementation of a Cyprus settlement. Precedents for such EU funding have occurred for peace in Northern Ireland and Germany reunification. Furthermore, funding should be available from a donor's conference to raise funds⁶. While lower income levels in northern Cyprus may result in greater EU support through cohesion funds.
 - (xiv) The implications of a Cyprus Settlement on the Environment of Cyprus, with special emphasis on the areas of the buffer zone and north of the Green Line (including the area of territorial adjustment) have not been studied, yet the massive movement and resettlement of people could cause serious environmental degradation. A study is urgently required. The most important areas that need to be protected are identified in the Life Study entitled "Special Areas for Conservation in Cyprus, Life Third countries 1998 Project" and the work undertaken on both sides of the Green Line on Natura 2000 protected areas, as well as the 2008-2009 UNDP-ACT-funded study on biodiversity in the buffer zone. The studies provide a basis for sustainable development planning in the whole island, but especially in the buffer zone and north of the Green Line where most of the resettlement will take place. There exists a basis for planning a sustainable future, but an institutional framework for cooperation is required.
 - (xv) The estimates for Scenario 2 regarding the solution to the Cyprus problem are based on a PEC definition of the economic factors in a Cyprus settlement which also provides a good basis for preparation of Report 'B'⁷.
- (2) Cross boundary movement and economic interdependence: The following factors were considered as facilitating greater movement from north to south and vice versa, after a solution:
- The elimination of crossing point procedures will make travel easier and reduce the time and monetary cost of crossing the Federated State boundary.
 - The integration of the road network will make movement and interaction easier. Proposals exist for 29 link roads but others will be necessary and the motorway network should be expanded to integrate the road network⁸.
 - Freedom of movement of people, goods, services and capital on the island. This is very important and is a major factor in the negotiations for a Cyprus Settlement. It should thus be treated as a top priority issue.
 - The large population close to the boundary line. The population of Cyprus living within 10 kilometres of the boundary line, will have easy access to the other Federated State. It is estimated that 450,000 people live within 10 kilometres of the line. Without checkpoints they will be very responsive to price differentials, and therefore economic interdependence will be encouraged.
 - Commuting for work. The population commuting to work to Lefkosia/Lefkoşa and Ammohostos/GaziMağusa both of which straddle the boundary line, will extend from Bogazi/Boğaz in the Karpasia/Karpaz to Kophinou/Kornihu on the Lemesos/Limasol road and from Kerinia/Girne to Palechori/Palehor. A 50 kilometre commuting radius is realistic and similar to present patterns, and people would be able to work in either Federated State more easily.
 - Employment of GCs and TCs in the Federal Government is estimated at up to 5,000 people in direct federal employment in buildings scattered around Nicosia / Lefkoşa and other towns. These will also create demand for a labour multiplier effect of 1.7, making

⁶ About \$1 billion was raised in 2004 at the donor's conference despite uncertainty over the referendum.

⁷ The PEC definition of the economic factors in a Cyprus settlement is available from www.cpnet.net

⁸ Proposals were made by the GCC Public Works Department representative at the Committee for Reconstruction and Resettlement conference on "Integrating Transport in a Reunited Cyprus", 2008.

another 8,500 indirectly employed as a result of federal civil service expenditure. Therefore, about 13,500 or about 3% of the employed population would be dependent on Federal employment directly or indirectly. Most of this labour force is already employed in public service departments that will be federal, but this shows how the agreement affects interdependence.

- The opening of the Kokkina-Limnitis/Erenköy–Yeşilırmak road will open up Tylliria/Dillirga and the northern Pafos/Baf District around Polis/Poli for easy access to Lefkosia/Lefkoşa and other towns, requiring travel through both federated states.
- The overall conclusion is that there will be considerable movement from one federated state to the other, and often the other community may have facilities more favourably placed, or more competitive, to create interaction. Under such circumstances economic interdependence has great potential for development under Scenario 2.

- (3) Aircraft connections will be improved and flight costs reduced for both communities and for travellers to Cyprus.
- Cyprus Airways will have reduced flight costs and shorter flight times to many destinations.
 - Turkish Cypriot airlines will have reduced flight costs to some destinations, but also be able to operate to other countries in the region.

(4) Identification of Post-Solution Key Issues

The following post solution issues have been identified and it is recommended that under a solution mechanisms be in place to encourage cooperation by the Federal and Federated State authorities and the GCC and TCC to address these issues.

- Resettlement of people.
- Identification of groups that may suffer as a result of a solution, and provision of support.
- Development of programmes for addressing the problems of groups that are affected (i.e. housing needs arising from resettlement and restitution).
- Re-creation of communities (schools, village administration, participation etc).
- Establishment of services (education health etc).
- Develop cooperation in higher education and research.
- Cooperate in incubator development for research and development of innovation products.
- Encourage cooperation on social issues with All Cyprus Trade Union Forum.
- Research into the possible development of GCC and TCC wages following a Cyprus Settlement.
- Measures for unifying labour market (Greek, Turkish and English language training, social insurance, labour regulations and health standards etc).
- Cooperation to plan in a sustainable manner the implementation of the solution itself (territorial adjustment, resettlement, re-integration of infrastructure), and to conserve the environment.
- Cooperation on social problems arising from a settlement (to be studied prior to a settlement).
- Cooperation on the energy sector (natural gas, electricity grid etc).
- Cooperation on water supply and sewage systems.
- Integration of the road network and harmonization of transport regulations.
- Establishment of services (education health etc).

Challenges

(1) There are two major economic challenges under Scenario 2 (a Cyprus settlement):

- The implementation and financing of an agreement in as smooth and efficient a manner as possible, while at the same time developing a system of governance that works in a practical manner in line with EU law, economic policy and financial standards. Particular reference is made to the need to undertake territorial adjustment and resettlement within the time frame.

- Developing appropriate economic and social policies that would help reduce and eventually eliminate income disparities within a reasonable time frame. Such measures would help to support the implementation of the settlement and the development of cooperation between the GCC and TCC.

(2) Other important challenges relate to the following:

- (i) Ensuring the financial viability of all levels of government (Federal, Federated State, Municipal and community levels).
- (ii) Establishing a unified electricity grid, and coordinated energy policy (electricity, oil storage terminal, natural gas terminal, natural gas pipelines etc) under a Federal System where executive powers are divided and in accordance with EU directives.
- (iii) Coordinating economic policy at all levels, preventing tax competition, and managing effectively macroeconomic policy.
- (iv) Reducing income disparities between the GCC and TCC.
- (v) Encouraging economic interdependence and creating a single market.
- (vi) Facilitating the harmonization to EU law of the TCC and the TC administered Federated State.
- (vii) Facilitating the improvement of TCC competitiveness within the constraints of EU law.
- (viii) Developing where possible complementary business activities between the GCC and TCC.

Opportunities

(1) Opportunities for cooperation and interdependence between the GCC and TCC will arise through the following:

- Cooperation in trade of imported goods (especially from Turkey).
- There would be easier GCC access to Turkish market for tourism and trade, and encouragement of cooperation.
- TC access to EU and world market and encouragement of cooperation.
- Cooperation in tourism, joint tours in both Federated States, day trips by tourists, round Cyprus scenic drives etc.
- Bi-communal Cooperation on tours to and from Turkey.
- Cooperation of TC agents of Turkish companies with GC businesses, to promote Turkish goods under the EU-Turkey customs union.
- Cooperation in shipping with Turkey, strengthening of Cyprus's position as a shipping state, and as a ship management centre.
- Road transport through Turkey will create further opportunities for cooperation particularly for trade with Iraq, Iran and the Caucasus.
- Easier access of both communities overseas through air travel routes through airports and ports in both federated states.
- Easier access to on-island natural resources (water, quarrying materials and possibly copper).
- Reduced shipping costs for imports and exports for TC businesses.
- Interdependence encouraged by common standards and EU harmonization.
- Integration of utilities will create benefits (water, sewage, telecoms, electricity, fuel depots, and natural gas).
- Production and service clusters that improve scale economies by specializing in production and marketing cooperation.
- Increase in cooperation (and competition) in both air and sea transport and between the island's ports and airports.

(2) Cooperation in the development of natural resources which are assumed a federal function, especially water resources, mining / quarrying, and the continental shelf (i.e. anticipated natural gas), and easier access to natural resources.

- Transfer of water from Turkey by pipeline appears to be an option, particularly for the expansion of irrigated agriculture.

- In the event that natural gas is found in the Cyprus economic zone, then this will provide a basis for cooperation, and all the population will benefit, and there should be fiscal revenue benefits at all levels.
- (3) Cooperation in the energy sector. With special reference to the introduction of natural gas in power stations, reducing pollution from electricity power stations, and the exploration of natural gas prospects in the continental shelf.
- The most appropriate arrangement would be for the electricity distribution system to be federal or common to both communities, and this would put the whole population of the country in a system of economic interdependence. It would provide immediate improvements for Turkish Cypriots, but would involve a massive programme of upgrading the distribution system in the northern federated state. Most importantly it would provide a sound basis for further development of a more sustainable and less polluting energy system.
 - In depth research studies are needed on how the electricity and energy sectors should be organized and developed under Scenario 2, in a manner that facilitates the creation of unified markets and meets the requirements of both communities and the EU. Cooperation on electricity production and distribution (i.e. a joint grid) and the EU requirements for reserve energy stocks could prove major areas for future cooperation if the system is set up in the right way. Among other advantages, such measures would virtually eliminate power cuts for the TCC. There are issues that have to be considered such as official regulators, integrated electricity network, EU energy directives, environmental standards for power stations, use of natural gas and exploitation of off-shore gas deposits.
 - Cooperation and coordination in the development of renewable energy sources, their finance and subsidization, notably wind, solar and waste driven electricity and heating/cooling systems. Such subsidization systems should be determined by cooperation of Federal Government and Federated States, and should be coordinated and harmonized.
 - In the event that a natural gas field is confirmed in the Cyprus undersea economic zone, the prospects for the energy sector will be revolutionized. Exploitation of such resources could take place in the medium to longer term (within a decade).
 - Access to gas pipelines in Turkey would benefit shipping registered or managed in Cyprus.
 - Opportunities may arise for the use of Cyprus as a natural gas regional storage centre, or as a crossing point for oil and gas pipelines.
- (4) Opportunities for the TCC
- Enlarged market, greater interdependence, economies of scale.
 - Improved competitiveness owing to entry into the single market.
 - Macroeconomic stability.
 - Integration into the European and world economy.
 - Improved service from financial sector (i.e. easier borrowing, lower interest rates).
 - Potential export markets.
 - Lower transportation costs.
 - Greater access to EU programmes.
 - Increase in tourist arrivals.
 - Intra-island trade of imported goods (currently not allowed across Green Line).
 - Increased employment opportunities.
 - Expanded market for Turkish products in GCC, and GC/TC cooperation.
 - Expansion of Irrigation (either from northern Troodos or from Turkey or both).
 - Improved electricity supply.
 - Improved potential to attract foreign direct investment (resolution of property issue, lower political risk).
 - Further development as an international business centre, and attraction of Turkish companies.
 - Increased demand for construction and recovery of real estate market.
 - Diversification and strengthening and market expansion of Tertiary Education.
 - Increased employment opportunities, especially for TCs encouraged by lower travel cost and time savings in crossing boundary line, and increased demand for labour in GCC.

- Greater product choice for consumers.
- Easier access to religious sites, traditional buildings, historic monuments.
- Reform of business activity through participation in a more competitive market.
- Increase in productivity through greater competition.
- Improved access to natural resources.
- Share of benefits from development of undersea gas.
- Easier access to Middle East, Caucasus, Iran and other markets.
- Improved competitiveness of the TCC economy through competition in both the international and Cyprus markets⁹.

(5) Opportunities for the GCC

- New dynamics for development will be created following territorial adjustments.
- Demand created by implementation of a Cyprus Settlement (infrastructure, resettlement).
- GCC access to Turkish oil and gas terminals will reduce supply costs, but also encourage further Cyprus shipping and ship management.
- Potential for cooperation (GCC, TCC cooperation) with respect to Turkish, Middle East and Central Asian markets, imports from Turkey, and in utilization of natural resources.
- Access to Turkish market, especially tourist market.
- Expansion of shopping services.
- Easier and cheaper access to shopping, recreation and religious sites in the northern part of Cyprus.
- Increased demand for construction and for real estate.
- Strengthened international business centre.
- Elimination of costs relating from the present situation and current constraints.
- Development of areas along the Green Line.
- Development as transportation hub.
- Lower air transport costs to Turkey, Ukraine, Russia and Central and northern Europe, Iraq and Iran.
- Development of undersea gas resources.
- Potential for cheap water from Turkey.
- Improved potential to attract more foreign direct investment (i.e. reduction of political risk).
- Improved potential as an international Higher Education and Health Centre.

MAIN RECOMMENDATIONS

There are more than 120 recommendations presented in the report. The main recommendations are shown below for each of the two scenarios:

- Interdependence (Scenario 1) a delayed solution.
- Interdependence (Scenario 2) a Cyprus settlement.

Under both scenarios the recommendations below are presented in two categories, policy issues and measures and opportunities for the Chambers. Recommendations by sector are to be found in Enclosure 1.

RECOMMENDATIONS (SCENARIO 1)

Policy Issues and Measures

All the recommendations below are intended to improve economic interdependence and competitiveness of the island as a whole, within the framework of an environmentally sustainable economic development approach.

⁹Especially if the reforms set out in the “Competitiveness Reports” 2008, 2009 of the TCC are implemented.

(1) Monitoring and Statistical Compatibility

- i. Economic interdependence should be monitored by developing the PEC methodology further, encouraging compatible data in both communities and organization of one large survey a year at all crossing points. This will enable progress to be better assessed in a systematic manner. Ideally this could be undertaken by the Working Group on Economic Affairs or the Technical Committee on Intra-Island trade. If that is not possible the Chambers of Commerce (CCCI and TCCC) could be funded to undertake monitoring of economic interdependence.
- ii. Closer cooperation in preparation of statistical data between the GCC and TCC authorities, would facilitate monitoring of Green Line Trade, the resolution of the statistical problems on movement across the Green Line and implications of economic interaction on “national” accounts data methodology.
- iii. Harmonization of Statistics: The TCC should harmonize its economic statistics with the EU so that comparable data for the whole of the Cyprus may be developed. This is included in the TCC harmonization policy, but must be brought forward as a matter of urgency, so that proper comparisons can be made.

(2) Measures to deal with “psychological barriers” to Intra-Island trade

- (i) There must be a clear statement of policy by the leadership of both communities in favour of economic cooperation, interaction and interdependence. Furthermore the GCC and TCC authorities should actively support economic interdependence in cooperation with the CCCI and TCCC. There should be a clear statement in favour of the broadly defined intra-island trade and guidelines for businesses.
- (ii) The CCCI, TCCC and TCCI should be supported in their efforts to encourage economic interdependence, by provision of financial support, open participation in activities, and through complementary action. The GCC and TCC authorities should provide financial assistance for their activities, and official support in dealing with the problems that arise both at the technical level and in public relations.
- (iii) A public information programme should be undertaken to inform the public in both communities that the aim of economic interdependence is to facilitate and prepare for the reunification of the island by reducing economic disparities and facilitating increased competitiveness of the TCC economy.
- (iv) The administrative bodies involved in trade and the internal market, the customs authorities and others should openly support intra-island trade and economic interdependence.
- (v) Public information programmes should be introduced to explain to business people and the public at large the rules of Green Line trade, and the advantages of economic cooperation. For example, public debates, televised public service announcements, more Green Line Trade seminars etc.
- (vi) Training programmes on economic interaction and Green Line Trade should be organized for GCC and TCC authorities, businesses, bankers and consultants.
- (vii) All programmes and regulations designed to promote economic interdependence or assist TCC business and consumers should be available on the website of the Cyprus Producers Network project (www.cpnnet.net).

(3) Measures to Encourage Cooperation and Crossings

- (i) International professional bodies (ACA, ACCA, RICS etc) operating in Cyprus should encourage GC and TC professionals to meet and cooperate on common programmes and activities.
- (ii) The opening up of more crossing points to facilitate movement and economic interaction.
- (iii) Cypriot professional bodies should be encouraged to meet and cooperate, and embark on joint projects. This could include agriculturists, veterinary surgeons, foresters, fisherman, bar associations, doctors, dentists, accountants, economists etc. Grant aid projects on the line of ENGAGED could help in this respect.
- (iv) Cooperation between academics could be encouraged by integrating them into an intercommunal association for academic research.

- (v) Economic cooperation between GC and TC companies should be encouraged, including through trade, memoranda of understanding, consortia and joint ventures.
- (vi) Encourage the setting up of internationally registered NGOs through which GCs and TCs can cooperate, thereby overcoming the problem of where to register the entity proposed.
- (vii) The All Cyprus Trade Union Forum should be encouraged to promote cooperation, employment and interdependence. It could be involved in issues regarding TCC employment south of Green Line, adoption of EU labour safety standards, harmonization in the workplace, transferability of social security etc.
- (viii) Cooperation to facilitate mobile phone roaming across Green Line.

(4) Measures to expand intra-island trade

- i. Expand Green Line trade to animal products by TCC harmonization with the EU *acquis*, and maintenance of high TCC veterinary standards, under EU supervision. The TCC should also reciprocate. Conduct public opinion polls and focus group discussions with the private sector about which additional products should be allowed, in their opinion, under Green Line Trade.
- ii. The TCC harmonization program for the adoption of the EU *acquis* should be implemented as soon as possible to facilitate intra-island trade.
- iii. The TCC adoption of EU and Cyprus trade standards and quality and health standards as soon as possible within the context of (ii) above, would encourage the development of trade. In line with this arrangements should be made for appropriate supervision (particularly for health standards).
- iv. Removing the provision for TCC permits and the charging of duties for GCC goods to be sold to TCC.
- v. Dealing with the VAT problem of GC goods sold to the TCC (they are charged VAT twice by both authorities) in conjunction with the non VAT charge on TC goods sold to the GCC.
- vi. Undertaking a detailed study on processing of TCC citrus products in GCC factories would help identify the reasons why such trade does not take place (i.e. EU subsidies etc)¹⁰.
- vii. The utilization of consultants to advise firms on Green Line trade would be useful, because consultants are not generally used at present. The subsidization of marketing studies under the Economic Interdependence Project is a step forward. Results should be evaluated, because the studies have provided a better understanding of the issues. The Chambers should lead this process and host the roster of consultants, which should be accessible through the Interdependence website.
- viii. The preparation of a manual for Green Line regulations, the VAT arrangements, the issue of labelling, problems encountered (i.e. bouncing cheques etc), distribution and delivery, and best practices. To be available in English, Greek and Turkish, and to cover Green Line Trade GCC to TCC and TCC to GCC.
- ix. Homogeneous goods should be promoted, such as agricultural products and construction inputs which do not encounter the “psychological problem” because they are not recognizable as TCC or GCC products. Own brands such as “supermarket brands” have a similar advantage, and offer prospects for Green Line trade.
- x. The problems of packaging and labelling have to be encountered by professional advice on using suitable packaging, registration of trade mark, “made in Cyprus” labelling and an appropriate address.
- xi. A TCC company registered in the GCC could provide an appropriate address, and facilities for many TC companies engaged in Green Line trade, as well as facilitate the organization of distribution (storage, distribution etc).
- xii. Re-connect value chains across the divide by providing more incentives for the creation of joint products
- xiii. Re-vitalise the green line by using more civilian-use areas for joint ventures. And bring together architects, engineers, planners, citizens, private sector etc. into a committee to theorise about re-developing some areas of the island into “bi-communal area of cooperation and trade”.

¹⁰ In the 2006 EDGE Report on “Intra-Island Trade” the problems resulted from EU subsidies to GCC oranges, which made TCC oranges non-competitive.

(5) Environmental Sustainability

- i. The examination of cases where Green Line trade may have aggravated environmental problems and encouragement of bicomunal cooperation to resolve problems such as:
 - Processing of lead from car batteries
 - Quarry operations for building materials
 - Implementation of pollution standards in the manufacturing process (i.e. bricks).
- ii. Establishment of an inter-communal commission for planning and coordinating sustainable development and environmental conservation.
- iii. The urgent need for a plan for conservation of the environment and sustainable development in the buffer zone and the area north of the Green Line, to facilitate implementation of a Cyprus settlement (Scenario 2). Such a plan should be prepared before a settlement and include the following:
 - Consideration of the areas that need to be conserved, and micro-reserves, in order to avoid damage to sensitive environmental area.
 - Establish guidelines for development within and around the 8 areas in the TCC identified under the LIFE 1998 project.
 - Establish guidelines for GC and TC resettlement in the villages located in these sensitive areas.
 - Examine the possibility of co-operation in waste materials collection and recycling through the Green Dot organisation.

(6) Sustainable Economic Interdependence:

- (i) The systematic study of the rehabilitation of abandoned buildings along the Green Line in Nicosia, and their commercial use, with initial emphasis at crossing points.
- (ii) The provision of finance and incentives for such rehabilitation.
- (iii) The continuation of market research studies undertaken under the Economic Interdependence Project for the encouragement of Green Line trade by industry subsector. For example: wine, brandy, spirits, soft drinks, breakfast cereals and biscuits (GCC to TCC), food, drink and clothing (TCC to GCC)
- (iv) Undertake the measures proposed by the TCC in the 2009-2010 "Competitiveness Report on the Turkish Cypriot Economy" in order to increase production efficiency, including:
 - Improving financial market efficiency
 - Enhancing private sector development
 - Harmonize with the EU acquis

(7) Social / Political Sustainability (Scenario 1)

- i. Training in participatory planning as a tool to be used in different sectors at various levels, and the undertaking of exercises or projects through public participation.
- ii. Implementation of a programme of promoting diversity and social inclusion to make transition easier, especially within a future Federal Civil Service.
- iii. A study of the reasons for the per capita income disparity between the GCC and TCC, noting especially the relatively low TCC activity rate, the labour force and population structure, and the much lower disparity of productivity of the TCC in relation to per capita income.
- iv. A study of the labour force engaged in the TCC in agriculture to estimate the degree to which territorial adjustment will affect TCC employment¹¹.
- v. A study of the social groups that will be affected by a Cyprus settlement, namely:
 - Those affected by territorial adjustment, and requiring resettlement (GCs, TCs).

¹¹The TCC Statistics show a very low agricultural labour force of 3,171 for all the TCC in 2008. This is assessed as very low, arising from the methodology used. But it is an important issue that has to be researched, because if the results are unrealistic then the social and economic repercussions of resettlement are reduced.

- Those wishing to resettle in the “other” Federated State (problems of restitution, creation of community, schools, religion etc).
- How the poor will be affected.
- The impact on different social groups and how to mitigate impact.

Opportunities for the Chambers

The CCCI and TCCC are cooperating closely on Green Line Trade and within the context of the Economic Interdependence Project. It is considered that their further cooperation on EU Harmonization and sustainable development would be beneficial for business in both communities, and for the two communities in general. It is recommended that the two Chambers (CCCI and TCC) cooperate with respect to the following:

- (1) Administration and organization of a system of information and cooperation on EU regulations, changes in policy and standards in relation to Green Line trade.
- (2) The organization of workshops on the type of problems that are created by implementation of the *acquis*, and the lessons learnt.
- (3) Information on EU programmes in the GCC and how they operate, for example:
 - Agriculture and rural development policy and subsidies.
 - Standards for food processing in traditional units.
 - Renewable energy policies.
 - Assistance to SMEs etc.
 - State Aids Commissioner
 - Commission for the Protection of Competition
 - Deminimis subsidies to business
- (4) Establishment of a monitoring system on economic interdependence based on the PEC methodology¹².
- (5) Cooperation on the EU experience in improving bureaucracy in member states.
- (6) Cooperation on consumer rights and company responsibility.
- (7) Cooperation on a dispute resolution mechanism in relation to Green Line trade.
- (8) Continuation of work undertaken by the Interdependence project and the Chambers, namely:
 - (i) Financial incentives for joint ventures
 - (ii) Trans-boundary market research
 - (iii) Green Line Trade Seminars
 - (iv) Informative media initiatives on Green Line Trade
 - (v) Regular updating of bi-communal business directory
 - (vi) Facilitation of cooperation between professional associations
 - (vii) Addressing bureaucratic obstacles to Green Line Trade
 - (viii) Focus group discussions and polling on consumer and private sector requirements from inter-communal trade
 - (ix) Register of consultants for Green Line Trade
 - (x) Updating Green Line Trade manuals
 - (xi) Businesspeople meetings facilitation

POST SETTLEMENT RECOMMENDATIONS (SOLUTION SCENARIO 2)

Policy Issues and Measures

(1) General

- i. In Study ‘B’ of the Economic Interdependence project a framework for an economic strategy appropriate to a Cyprus Settlement will be developed. The basic objectives of such a strategy should include the following:
 - Smooth implementation of the Cyprus Settlement (i.e. provision of adequate funds).
 - Sustainable development of the economy (i.e. recovery from recession, encouragement of sustainable growth).
 - Progress with economic convergence between the GCC and TCC.

¹² In the event that the GCC and TCC authorities do not respond to the need for monitoring.

- Appropriate exploitation of the economic opportunities that arise.
 - Development of economic cooperation and interdependence between the GCC and TCC, and the creation of mutual interest with a view to making the Cyprus Settlement a success.
- ii. The preparation of an Island Wide master plan for sustainable development; the aforementioned intercommunal commission should develop a comprehensive spatial plan for the reunification of Cyprus and its economic and social development, through a process of participatory planning, following a Cyprus settlement. This could be based on the following considerations:
- The methodology of the 1973 “Island Plan” approach integrating environment, development, infrastructure and geographical distribution of services.
 - The recommendations of the Cyprus 2015 report on sustainable development
 - The implementation of the Confidence-Building Measures proposed by the Environment Technical Committee.
 - The major spatial implications of a Cyprus settlement that may be affected or identified. Including the examination of Territorial adjustment, GCC and TCC resettlement
 - Integration of the infrastructure
 - Spatial distribution of services
 - Re-creation of communities
- iii. One issue that needs to be addressed is the urgent need for an environmental impact assessment in relation to a Cyprus settlement, and how to achieve growth with sustainability, and also protect the environment. This could be undertaken by the aforementioned intercommunal commission on sustainable development and the advanced planning described earlier.
- iv. In relation to the promotion of post solution Economic Interdependence, the following are proposed:
- Information should be provided to business about the changes that will take place in the economy, the economic effects of a solution and the opportunities.
 - Economic cooperation could be encouraged (i.e. cooperation on tenders).
 - Economic diversification should be encouraged to allow the TC and GC economies to become complementary rather than competing with each other.
 - Information on business opportunities (EU market, intra-island trade, EU-Turkey Customs Union, EU agreements with third countries).
 - Cooperation on EU programmes (joint actions)
 - Information on investment programmes relating to a Cyprus settlement.
- v. The integration of the banking system will create opportunities for cooperation.
- vi. An estimate of the benefits of a Cyprus settlement (peace dividends) will be included in Report ‘B’ of the economic interdependence project.
- vii. Continue public relations campaigns to encourage economic cooperation and interdependence after a solution.

(2) Post Solution Interdependence (Scenario 2)

- (i) Continuation of a programme after a settlement of encouraging GC and TC B2B cooperation in the new market environment to be created.
- (ii) Examine the possibility of promoting Turkish imports to GCC through GC/TC B2B cooperation, to prepare for the situation post-solution, when demand is likely to increase.
- (iii) Encourage meetings of GC and TC business people for discussion on the economic and business aspects of a solution, and how the process can proceed smoothly.
- (iv) Hold meetings with supermarkets about placing TC goods on shelves post-solution when the “psychological” concerns should be of reduced significance.
- (v) Encouragement of GC/TC cooperation on Federal and other public sector contracts.

(3) EU Harmonization

- i. A study of how the EU harmonization programme can be in place in the TCC (except for agreed derogations) at the time of reunification following a Cyprus settlement. Under Scenario 2 it must be assumed that on reunification in Cyprus the *acquis* should be in place at the time of reunification (except for limited, agreed, temporary derogations). But in accordance with PFAA even if the current programme is implemented only 12 Chapters will have been harmonized in the TCC by 2011. It is, therefore, recommended that:
 - The TCC harmonization programme is speeded up and the additional and missing chapters added.
 - The EU financial assistance to the TCC should concentrate more on TCC harmonization.
 - In the event of a Cyprus settlement, the agreement should be signed and 12 months given for harmonization to take place and for preparation for the adoption of the Euro on the date of reunification.
- ii. A cooperation agreement is required in order to regulate Federal and Federated State functions in relation to EU matters and to ensure consistency and coordination.
- iii. Cooperation on how to reorganize the electricity energy sector after a Cyprus settlement in line with the requirements of the *acquis*.
- iv. The establishment of a policy on EU oil storage requirements and how they can be met in a reunited federal Cyprus, involving Federal Government and Federated States.
- v. Joint units could be established for GCC / TCC participation in EU conferences or programmes under joint arrangements. This would enable TCs to gain experience in EU procedures but also to gain familiarity on the implementation of the *acquis*. It would also stimulate GCC / TCC cooperation, on issues of mutual concern (i.e. animal health, health standards etc).
- vi. The EU Harmonization programme should be enlarged to cover at least 16 chapters (preferably all 32) and priority be given to key chapters such as freedom of movement, goods, people and capital).
- vii. EU Harmonization would be facilitated and the Cyprus Settlement could be implemented more easily if the following issues were addressed:
 - The omission of intellectual property rights and trade marks in the TCC PFAA, however, implies that one of the major obstacles to Green Line trade (especially in TCC clothing) will not be tackled before a settlement. This constitutes a problem for economic interdependence under Scenario 1 but also Scenario 2.
 - The exclusion of freedom of movement of goods, workers and services (Chapters 1, 2, 3) from the priority harmonization constitutes an issue that has to be resolved within the process of the Cyprus talks. It is recommended that priority should be given to key elements of a Cyprus Settlement, because the TCC will only have 12 months to apply these Chapters after a Settlement¹³.
 - The EU should provide more assistance for the harmonization of the *acquis* by the TCC, than that implied by the PFAA.
 - Key Chapters affecting trade issues should have been given high priority for immediate action, because they affect Green Line trade under current conditions.
 - Freedom of movement of goods, workers and services should have been given priority, because it is a major factor in economic interdependence under present conditions. But most importantly because they are crucial for a Cyprus Settlement (Scenario 2).
 - Harmonization of improvements of banking and financial services is another area that is crucial for a Cyprus Settlement and for economic interdependence and again it is not given priority in the PFAA, other than in the free movement of capital (Chapter 17 Economic and Monetary Union is not given priority).

¹³ Chapters 1, 2, 3, 15, 17, 23, 24 are crucial to a Cyprus Settlement but are in the “additional” list not the priority list.

(4) Environmental Sustainability

- (i) Progress on environmental issues could be made through island wide environmental planning by the establishment of an institutional mechanism for coordination between Federal and Federated States on environmental policy. This could take the form of the coordination commission on macro-economic policy agreed, involving the appropriate ministers of the Federal and Federated State Governments.
- (ii) The guidance for planning should be provided by the studies recommended to be undertaken under Scenario 1, so that a good basis is in place for planning reunification and development, while at the same time preserving the most significant environmental areas and habitats. The spatial plans should provide a basis for town planning controls in areas of resettlement, a factor which should speed up well planned resettlement, while preserving the environment. The planning should be undertaken before a settlement is implemented, by the aforementioned intercommunal commission for sustainable development, using a multi-disciplinary approach and adhering to the principles of participatory planning (citizen participation).
- (iii) Natura 2000 and other strict conservation measures should be implemented and in place before a Cyprus settlement is reached.
- (iv) Resettlement of GCC and TCC displaced or affected persons should be undertaken in an appropriate manner, and guidelines should be provided for environmentally sensitive areas.
- (v) The utilization of existing buildings for resettlement would reduce costs, reduce the pressure of large scale population movement on the environment and facilitate quicker resettlement.
- (vi) The establishment of guidelines for sustainable development through agreements between Federal and Federated State administrations to facilitate development that respects the environment.
- (vii) After a Cyprus Settlement there should be policy cooperation on environmental issues between Federal and Federated State governments, based on constitutional provisions and tripartite cooperation laws, Federal laws, the constituent state constitutions and “cooperation agreements” between Federal Government and the Federated States which should be in place as part of the Cyprus settlement. It may be advisable that agreements are in place at the time of reunification to cover tripartite cooperation on natural resources, environment (especially if federal environmental areas are proposed), and pollution (which transcends boundaries or is a major risk for all i.e. cyanide poisoning risk from old mines, industrial effluent).
- (viii) Cooperation on spatial planning
 - Town and country planning
 - Resettlement programmes
 - Conservation of environment
 - Energy distribution
 - Improvements and re-connection of roads and public transport for Lefkosia / Lefkoşa and Ammohostos / GaziMağusa (ring roads, light rail system etc).

(5) Sustainable Economic Development

- (i) The organization of the electricity and energy sectors is central to post-solution economic interdependence, and it is recommended that serious consideration be given to the following:
 - A unified electricity grid and distribution system.
 - Development of private sector power stations in accordance to EU directives.
 - Cooperation in adapting oil fired power stations to natural gas, in line with EU directives.
 - Cooperation in distribution of natural gas to both communities.
 - Development of a coordinated strategy for meeting EU targets for renewable energy systems, in particular incentives for RES development as inter-communal ventures, support for solar power facilities once the buffer zone is opened up for development, establishment of a federal R&D unit on renewable energies.
- (ii) Development of a joint strategy for implementation of the EU water framework objective.
- (iii) Cooperation on sewage treatment and use of treated water (regulations, health standards for such water use, and agricultural goods produced).
- (iv) Examination of how cooperation on water supplies can be undertaken between Federal Government and Federated States under a solution (water quantities, standards, pricing).

- (v) Mutual benefits from exploitation of natural gas (if confirmed) in the undersea Cyprus Economic Zone and positioning Cyprus to take full advantage of its strategic position at the crossroads of major oil and gas pipelines and shipping routes in the region.
- (vi) The examination of EU oil storage requirements and how they can be met in a reunited Cyprus. Cooperation and coordination on the implementation of energy storage policy in the EU. Such cooperation should reduce costs and limit the oil storage capacity required in Cyprus as a whole.
- (vii) Re-integration and re-connection of transport network and infrastructure island wide, with a focus on environmental sustainability (e.g. light rail network)

(6) Social / Political Sustainability

The analysis of the studies on income disparities, labour force and affected social groups to attain some idea of the social impact of a Cyprus settlement, that would lead to policies designed to address the problems. The inclusion of measures to facilitate social inclusion and cooperation in diversity above, also facilitate policies designed to support political stability.

Opportunities for the Chambers

The Chambers of Commerce must participate actively in the implementation of a Cyprus settlement to facilitate the smooth reunification of the island and the economy.

(1) The Chambers should participate in the reunification process through:

- (i) Advisory committees to facilitate the participation of the private sector in the process, including tender procedures, implementation problems, resettlement of businesses and agricultural units, etc.
- (ii) Facilitating the harmonization process and the establishment of common product standards.
- (iii) Ensuring a level playing field in trade and business activity.
- (iv) Advising on sorting out problems such as duplication of company names and trademarks.
- (v) Advising on harmonization of company law, company taxation and other issues.

(2) General Chamber cooperation

- i. Economic diversification of the TC and GC economies towards complementary activities.
- ii. Provide information on business cooperation opportunities and changes in economy
- iii. Cooperation on EU programmes including training and information for harmonization
- iv. Information on investment programmes, subsidies etc
- v. Encourage GC/TC B2B cooperation
- vi. Promote Turkish imports to GCC via GC/TC B2B arrangements
- vii. Establish a Federal Chamber of Commerce (undertake a relevant study) that would also have an advisory role in the reunification process
- viii. Focus group discussions and meetings with business leaders to discuss economic impact of a settlement
- ix. Meetings with supermarkets to get more products from the other community on shelves
- x. Encourage cooperation on federal and other public sector contracts (e.g. tenders)
- xi. Provide information on standards, health and safety regulations
- xii. Cooperate on safety at work regulations and implementation

CONCLUSIONS

Report 'A' has inter alia established a basis for proceeding to consider the framework for economic policy after a Cyprus Settlement (Report 'B'). The conclusions from Report 'A' are as follows:

The current level of interdependence is much larger than commonly perceived at around €300m in 2009. The revenues flowing to the TCC are estimated at €192m and the outflows at €109m, giving a net gain for the TCC of around €83m. These are significantly greater than TCC inflows through international trade (€56m in 2008). These net benefits of the TCC are derived from expenditure by visitors across Green Line, Green Line trade, employment in the GCC economy, and pension payments to TCs.

TCC expenditure in the GCC has been increasing rapidly, from an estimated €50m in 2005 to €126m in 2008, falling back because of the economic crisis to €109m in 2009. In 2008 TCC expenditure from movement across the Green Line exceeded that of GCC from movement alone, but labour income, Green Line trade, pensions and health benefits resulted in the net benefit for the TCC describe above.

The psychological reservations are the major restriction on movement and one of the main factors that restricts business-to-business cooperation. Furthermore, the time and cash cost of going through the checkpoints is a significant cost, and a further limitation on movement.

Reunification will greatly change the habits created by the Green Line and 450,000 people will live within 10 kilometres of the boundary line. A significant proportion of GC's and TC's will live in the Federated State administered by the other community, at least in the transition period, and from then on in accordance with the Cyprus Settlement.

With respect to Study 'B' the framework has been established for Scenario 2, and many of the major factors affecting the development of a framework for an economic strategy under a Cyprus Settlement have been determined. But the current economic recession has made a solution very difficult to finance from local sources, consequently attention must be given to how a solution can be financed. A time schedule for implementing the solution has been set out which allows an assessment of the financial requirements of a settlement over the implementation time period. It is fundamental that the financial resources be in place for the smooth implementation of reunification, and therefore funding based on stage by stage costs should be seriously considered. Priority must be given to financing and making the solution work under a settlement. Certainly the anticipated recovery of the Cyprus economy will make implementation of a settlement easier but financial assistance from the EU, donor countries and international organizations will still be required.

The study concludes that economic interdependence is developing, there is evidence that the two markets affect each other to some extent, and that in terms of GDP the positive impact is mainly on the wholesale/retail sector, restaurants and tourism. Such interdependence improves competitiveness and helps businesses to prepare for a Cyprus settlement. Work is continuing on the second stage of the study, which aims at examining the economic development of the island after a Cyprus settlement and setting out a framework for a joint economic development plan.

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ENCLOSURE 1: SECTORAL RECOMMENDATIONS (SCENARIO 1)

1.	Mining and Quarrying
	(i) The TCC should adopt EU environmental standards
	(ii) The TCC should adopt EU and GCC quality standards for quarrying products
	(iii) Support joint clean-up of CMC area by GC/TC consortium
2.	Electricity, Gas and Water
	(i) The existing cooperation on water supply across the Green Line should be re-examined: <ul style="list-style-type: none"> • The commercial aspects of supply discussed and where necessary improvements agreed. e.g. extension of “peace pipeline”?
	(ii) The policy and arrangements for electricity supply from the GCC to TCC should be: <ul style="list-style-type: none"> • Studied with a view to establishing cooperation on a commercial basis. • Options to support renewable energies examined. • Cooperation on R&D considered. • Consider renewable energy options (wind, solar, waste utilization).
	(iii) The TCC should adopt EU and GCC standards for gas cylinders for trade to take place.
3.	Construction Sector
	(i) The existing GCC policy (introduced in 2003) of encouraging contracting work to TC construction companies for work north of the Green Line, or cooperation between GC and TC construction companies, should be promoted and implemented. ¹⁴
	(ii) Projects of mutual interest such as the opening of additional crossing points and associated road improvements should be agreed, planned and implemented
	(iii) Sustainable, energy-efficient construction standards island-wide should be agreed
4.	Wholesale and Retail Trade
	(i) The opening of additional Green Line crossing points should be considered
	(ii) Trade between the two communities should be encouraged
5.	Tourism / Hotels, Restaurants / Recreation
	(i) Encouragement of tourist day visits across Green Line
	(ii) Encouragement of tourism holidays and tours on both sides of Green Line in appropriate accommodation
	(iii) Provision of statistical data on tourism movements across the Green Line
6.	Financial Sector
	(i) Meetings of bankers and others to improve understanding on how financial sector operates on both sides of Green Line. <ul style="list-style-type: none"> • Improve banking interactions across the Green Line (electronic transactions, cheque clearance)
	(ii) Consideration of how SWIFT can be introduced for TC banks.
7.	Real Estate / Business Services
	(i) Encourage cooperation and harmonization of standards and practices in business services through associations (land valuers, consultants, professional services).
	(ii) Coordinate on green construction.
8.	Public Administration
	(i) Establish a joint committee on GCC and TCC cooperation in public services on the same basis of the Joint Unit on Criminal Matters.
	(ii) Undertake research on areas of common interest (i.e. water supply, sewerage, the risks from old mining activity (i.e. cyanide poisoning), health and environmental risks.
	(iii) Encourage public employee trade unions to cooperate and advise the leadership on areas of GCC and TCC public sector cooperation.
9.	Education Sector
	(i) Cooperation in the amendment of books to facilitate reconciliation

¹⁴Introduced in a package of measures on 30th April 2003.

	(ii) Cooperation on the following: <ul style="list-style-type: none"> • Educational Island tours of GCC and TCC students (separately or together). • Environmental education tours.
	(iii) Informal meetings of teachers through trade unions to consider teaching programmes (curricula, levels of attainment etc).
	(iv) Cooperation on programmes to promote the English, Greek and Turkish languages.
10.	Health Sector
	(i) A joint unit should be set up to look into the issues of public health and food products in relation to Green Line trade.
	(ii) A joint standing unit on epidemic and health threats should be set up to develop emergency programmes and cooperate on health risks.
11.	Communications and Transport
	(i) Roaming arrangements for mobile phones across Green Line.
	(ii) Re-examination of possibilities for heavy vehicle driving licence harmonization.
	(iii) Re-examination of heavy vehicle harmonization of vehicle inspections.