



The Political Economy of a Cyprus Settlement: The Examination of Four Scenaria

Andreas Theophanous





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THE POLITICAL ECONOMY OF A CYPRUS SETTLEMENT: The Examination of Four Scenaria

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FOREWORD

PRIO's mission in Cyprus is to contribute to an informed public debate on key issues relevant to an eventual settlement of the Cyprus problem. We hope to achieve this by disseminating information, providing new analysis and facilitating dialogue. The PRIO Cyprus Centre wishes to stimulate research cooperation and debates between Greek Cypriots and Turkish Cypriots, as well as within each of the two communities, and in the international society.

PRIO is particularly happy to present PRIO Report 1/2008, authored by Professor of Economics Andreas Theophanous, who invites a broad discussion throughout Cyprus and abroad about the economic implications of four different scenarios for the island's political and constitutional future. He does this at a time when there is renewed hope for a solution to the Cyprus problem, although many Cypriots warn on the basis of their past experiences, against excessive optimism.

This is the sixth report from the PRIO Cyprus Centre since it opened in 2005. Some reports have been written jointly by Greek Cypriots and Turkish Cypriots, some by authors from just one of the two communities. The present report has been written by a prominent Greek Cypriot academic, who seeks to engage all his fellow Cypriots in considering the economic aspects of Cyprus' possible futures.

The economic aspects of the Cyprus conflict have already been addressed in several reports, papers and conference proceedings from the PRIO Cyprus Centre. We are proud to be able to take this topic further at a time when politicians, negotiators and the general public need to keep the political economy of a comprehensive solution to the Cyprus problem in mind.

Let me express a hope I share with the author that the report will stimulate a constructive, forward-looking discussion. Scenario thinking is valuable since it may open our minds to future possibilities—both positive and negative—and help liberate us from the sometimes sterile quarrels generated by historical narratives and repetitive arguments.

As always, the views expressed in the PRIO Report are the author's own. They do not engage PRIO as an institution.

STEIN TØNNESSON
Director
International Peace Research Institute, Oslo (PRIO)

30 May 2008

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I have been preoccupied with the various aspects of the Cyprus question for years both as a scientist and as a concerned citizen of this country. My understanding of issues has been enriched over time by pursuing a multidisciplinary approach. Likewise sharing and exchanging views, perspectives and ideas with colleagues, as well as politicians, diplomats, journalists, active citizens, students and others has been extremely useful and rewarding.

This study, entitled “The Political Economy of a Cyprus Settlement: The Examination of Four Scenarios”, focuses on the economic aspects of the Cyprus problem. Constitutional, political, legal and other aspects are addressed to the extent that they contribute to this analysis.

This approach is particularly important and useful but unfortunately it has not been given its fair share of attention. The objective of this study has been to make a contribution to the debate in relation to this specific issue. Inevitably, however, economic issues in the broader sense of the term are affected by political, constitutional and legal issues. At the same time economic issues exert their own influence and impact on political and other variables. This means that economic issues and the solution to the Cyprus problem are intertwined.

This study would not have been possible without the support of PRIO. Special thanks go to Stein Tønnesson, Director, International Peace Research Institute, Oslo (PRIO) and Arne Strand, Centre Manager, PRIO Cyprus Centre, for their strong encouragement. I also appreciate very much Fiona Mullen’s contribution. Indeed her comments have been particularly helpful for the completion of this study. I also thank very much Kathy Stephanides and Andreas Ioannou for their editorial contribution.

I am also indebted to many colleagues and friends with whom I have repeatedly discussed, over time, both broader aspects and also complex issues related to the Cyprus problem. In particular my thanks go to Max Watson, Monroe Newman, Michael Sarris, Shlomo Avineri, Van Coufoudakis, Tozun Bahcheli, Hansjoerg Brey, Theodoros Pelagidis, Christos Ioannides, Nicos Peristianis, Michalis Attalides, Emiliou Solomou, Yiannis Tirkides and Nicholas Karides.

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It would be an omission if I do not refer to the help I received from the dedicated staff of the Cyprus Center for European and International Affairs. Special thanks go to my Personal Assistant Styliana Petrou for her valuable input.

Last but not least I thank my family for their sustained support and understanding for my long hours of work and the frequently interrupted weekends and holidays.

Andreas Theophanous

PREFACE

Conventional orthodoxy in relation to a possible solution of the Cyprus problem has revolved in the last forty years around the concept of a bizonal, bicomunal federation. Nevertheless, not only do the two communities have different interpretations of the concept but also within each community there exist various and confused perspectives.

This study focuses on four scenaria: (a) bizonal bicomunal federation, (b) stalemate/continuation of the *status quo*, (c) two-state solution, and (d) functional federation with loose bizonality. It should be stressed that each particular scenario leads to a unique set of arrangements and outcomes. Consequently, it would be wrong to assume that irrespective of the model of a solution the outcome would end up being more or less the same.

The best outcome derives from what I have described as a functional federation with loose bizonality, which may be viewed as a special case of a bizonal bicomunal federation. This model adopts an integrationalist federal approach and encourages cooperation and the emergence of common objectives. It also considers that socioeconomic convergence will be the outcome of several factors: certainly the central government will have to play a significant role and so will the special programmes and projects of the EU. However, the most important role will be played by market forces.

I agree with the theoretical proposition that if bi-ethnic and multi-ethnic societies are based (exclusively) on ethno-nationalist pillars it would be difficult if not impossible to sustain peace, cooperation, security and prosperity. The alternative paradigm put forward is based on civic nationalism. This refers to models that focus not on ethnonationalism but instead on a shared set of values.

The model that has been discussed for years as a probable solution to the Cyprus problem is essentially based on ethno-nationalist pillars. As such it has serious shortcomings. From an economic perspective it must be noted that a state founded on such pillars may lack the necessary economic dynamics to make it viable. Furthermore, it does not create the circumstances that lead to a comprehensive, cohesive and coordinated economic policy which is essential in promoting socioeconomic convergence. In addition, strong bizonality will not lead to an integrated economy and society.

According to the study, a functional federation with loose bizonality generates a preferred outcome. This model has a different philosophy. In line with conventional orthodoxy, it takes into serious consideration the objectives of the two ethnic communities; consequently, this model too is characterized by bi-communalism. On the other hand, though, it also attempts

to go beyond it. Furthermore, the model distinguishes between strict and loose bizonality and adopts the position that with the implementation of the latter, and in conjunction with the other characteristics of the model, it is possible to promote an integrated society, strong institutions and a viable and dynamic economy.

Andreas Theophanous
Nicosia, May 2008

INTRODUCTION

Objectives and Context

The objective of this research work is to examine the economic implications of four particular scenarios, or solutions, to the Cyprus problem. Social and political considerations are incorporated in our study to the extent that they influence economic outcomes and also enhance economic analysis. Discussion of the impact of each scenario on economic structure, economic growth, the potential creation of synergies, employment opportunities, fiscal considerations and property arrangements reveals that the four different scenarios would produce four very different outcomes. The implications of the accession of Cyprus to the Eurozone on January 1, 2008 are of particular significance, and Cyprus's adoption of the euro has potentially far-reaching implications; this issue will receive special attention.

We want to emphasize that an analysis focused on economic considerations is essential for numerous reasons. Traditionally discussions have focused on constitutional, legal and political aspects of a potential settlement, sidelining the political economy dimension. This has resulted in omissions as well as incomplete approaches towards any proposed settlement. Examination of the economic implications of the various scenarios is therefore crucial. Under most proposed solutions it would be essential for the two communities to agree on common social and economic goals as well as the means of achieving these goals. Inevitably economic considerations and ramifications have an impact on political and constitutional structures and vice versa. These issues must be addressed in a more systematic way. It is hoped that the present analysis will stimulate decision making by policy makers as well as the people.

There is another strong argument for undertaking an economic analysis. There seems to be a common assumption that regardless of the given solution, the economic implications would be basically the same and that these would be, overall, positive. This viewpoint is simplistic and misleading, and the present study aims to establish the essential need for, and critical importance of, a political economy assessment.

The Examination of Four Specific Scenarios

In this study we examine four specific scenarios:

- (a) Bizonal bicomunal federation;
- (b) Stalemate/continuation of the *status quo*;
- (c) Two-state solution;
- (d) Functional federation with loose bizonality.

We recognize that, upon close examination, each scenario may entail several versions and/or variations, and in turn each version or variation may be associated with different results. The possibility of variations in each scenario will be pointed out using specific examples, and in each case the possible repercussions will be addressed.

(a) *Bizonal bicomunal federation:*

Although both communities have agreed that any solution should be based on what is commonly called a bizonal bicomunal federation (the term/concept bizonal bicomunal federation has existed in the Cypriot political vocabulary for about three decades since the latter part of the 1970's), there have been widely divergent interpretations of this term – not only between but also *within* the two communities. It is also problematic that there has been no systematic study on the compatibility of the various constitutional models with economic objectives. It is imperative that the two communities understand the economic implications of their particular interpretation of a bizonal bicomunal federation.

(b) *Stalemate/Continuation of the status quo:*

The present stalemate entails particular socioeconomic practices and outcomes, as well as particular costs and foregone benefits. The stalemate is also dynamic in nature. Following the partial lifting of restrictions to free movement of persons on both sides of the Green Line on April 23, 2003 as well as the accession of the Republic of Cyprus to the EU on May 1, 2004, there have been additional important developments.¹ The post-2003 stalemate is a much different “setting” from what existed before and the two situations must be compared in the light of recent socioeconomic developments. It is also important to consider the wider economic implications of the current *status quo* and the potential political fallout.

(c) *Two-state solution:*

It has been suggested that a significant percentage of both Greek and Turkish Cypriots favour formal partition and a two-state solution, seeing this arrangement as more stable and simpler. It should also be noted in this regard that there are many Greek Cypriots who would prefer a reunified Cyprus but who voted against the Annan Plan² as they considered its overall philosophy worse than partition. At the same time many Turkish Cypriots feel that the Greek-Cypriot rejection of the Annan Plan signals a reluctance to live within a bizonal bicomunal federal arrangement. Be that as it may, it is important to examine the economic (and other) implications of this scenario for each community as well as for Cyprus as a whole, and to consider this scenario in relation to the other three. It would also be useful to extend this analysis beyond Cyprus, as it has significant implications for the broader region and the EU.

¹ At the time of finalization of this study, the Ledra Street opened on April 3, 2008, after 45 years. It is an important event but much work remains to be done for a comprehensive solution of the Cyprus problem.

² The Annan Plan was rejected by 75.8% of Greek Cypriots and accepted by 64.9% of Turkish Cypriots (and settlers who voted) in separate and simultaneous referenda held on April 24, 2004.

(d) Functional federation with loose bizonality:

There has been little consideration of any attempt that would incorporate the historical compromise of a bizonal bicomunal federation with the objective of integration. Likewise, there has been little consideration of how European political culture and norms could influence the specific constitutional and political formulation of the historical compromise embedded in the high level agreements of Makarios-Denktaş (1977) and Kyprianou-Denktaş (1979) (see Appendix A and B, respectively). Such a model would entail a set of specific economic implications and could significantly influence particular objectives. Before any conclusion can be reached it is essential to have a comprehensive socioeconomic picture of this scenario. It would be instructive to compare the particular socioeconomic outcomes of this model with the respective outcomes of the other three scenarios.

Structure of the Research Work

The study takes into consideration the new international economic environment and especially Cyprus's participation in the EU and the EMU. Thus, Cyprus's adoption of the euro as the national currency and the broader implications of this action are highlighted. Another area of particular emphasis relates to existing perceptions and misperceptions held by the two communities (as well as other parties directly and indirectly involved). With these parameters in mind we outline possible solutions/outcomes and consider what may be the most appropriate model for Cyprus.

Since the approaches taken by each community to the settlement of the Cyprus problem are influenced by history, in chapter I we undertake a literature review in relation to developments in the post-1960 period. We briefly refer to the situation before 1974, focus on perspectives in relation to the high level agreements of 1977 and 1979 and the efforts of the international community for a breakthrough culminating in the Annan Plan. We also briefly highlight perspectives in relation to the situation before and after April 2003.

Chapter II describes the theoretical framework for our examination of the four specific scenarios, outlining the major economic issues that will be addressed within each possible outcome. We further explain the strong relationship between constitutional arrangements and economic structure and also outline the economic objectives of the two sides.

In chapters III-VI we describe and assess the four scenarios. In the final and concluding chapter VII we explain the major results, our overall comparisons, assessments and policy recommendations. We also make suggestions for further research.

I. LITERATURE REVIEW: AN OVERVIEW OF THE POST-1960 PERIOD

As noted earlier, this study focuses primarily on economic issues and considerations in relation to the Cyprus problem. Any analysis which does not take into consideration economic factors would be inadequate and misleading. By the same token, it would be erroneous, equally misleading and inadequate to assume that only economic factors matter.

Political and constitutional considerations have economic consequences that affect issues like property arrangements, the degree of integration of the economy, the society and, moreover, economic structure and thereby economic variables and outcomes. We address these issues in relation to the various ideas and plans that have been proposed since 1974. But first it is essential to briefly assess the situation prior to 1974.

Before 1974¹

There has been little discussion of the economic ramifications of the 1960 constitution that established the Republic of Cyprus and the events that culminated in the 1974 crisis and debacle. Essentially the 1960 constitution involved a consociational arrangement and/or an administrative federation which meant, among other things, that many decisions required double majorities of the representatives of both communities. Indeed, the crisis of 1963 which led finally to the withdrawal of Turkish Cypriots from government, was precipitated by deadlocks in the decision-making processes.² Inevitably this had economic implications – for example, the non-approval of the annual budgets. Retrospectively one can see that the

¹ For interesting reading see D. Christodoulou, *Inside the Cyprus Miracle: Labours of an Embattled Mini-Economy*, (Modern Greek Studies, University of Minnesota, Minneapolis 1992); E. Mavros, "A social assessment of economic development in Cyprus", *Cyprus' Society from the Eve of Independence to 1984* (in Greek), (Lectures of the Peoples' / Open University, Nicosia Municipality, 1993), pp. 135-155; M. Dekleris, *The Cyprus Question 1972-1974: The Last Opportunity* (in Greek), (Estia, Athens 1981); K. C. Markides, *The Rise and Fall of the Cyprus Republic*, (Yale University Press, New Haven 1977); M. Attalides, *Cyprus: Nationalism and International Politics*, (St. Martin's Press, New York 1979); S. Kyriakides, *Cyprus: Constitutionalism and Crisis Government*, (Univ. of Pennsylvania Press, Philadelphia 1968); M. Attalides (Ed.), *Cyprus Reviewed*, (Nicosia 1977); N. Crawshaw, *The Cyprus Revolt: An Account of the Struggle for Union with Greece*, (George Allen and Unwin, London 1978); T. Bahcheli, "Cyprus in the Politics of Turkey" in N. Salem (Ed.), *Cyprus: A Regional Conflict and its Resolution*, (St. Martin's Press, New York), pp. 62-70; Z. Negatigil, "The Cyprus Conflict in International Law" in C. H. Dodd, *The Political and Social Development of Northern Cyprus*, (Eothen Press, Huntingdon 1993), pp. 46-74.

² See S. Kyriakides, *Cyprus: Constitutionalism and Crisis Government*, op. cit., especially pp. 53-162; B. O'Malley and I. Craig, *The Cyprus Conspiracy: America, Espionage and the Turkish Invasion*, (I.B. Tauris, London/New York 1999), especially pp. 87-93, Th. Ehrlich, *Cyprus 1958-1967*, (Oxford University Press, New York and London 1974).

different positions of the two sides could have been addressed in a positive manner had there been an understanding of broader and more fundamental objectives as well as a political atmosphere of openness, tolerance and mutual trust.

It is also essential to understand the context and the political atmosphere of the times and the demands of the two sides. Greek Cypriots felt that the constitution gave to Turkish Cypriots excessive rights/privileges that were not only unjust but created inefficiencies and bottlenecks in the functioning of the economy and the state. From their perspective Turkish Cypriots wanted to cling to all provisions of the 1960 constitution. They wanted to avoid marginalization in society and the state and they saw the constitution as an effective guarantee against such an outcome.³

Be that as it may, Archbishop Makarios, the then President of the Republic, proceeded to suggest 13 amendments to the constitution. This led to the 1963-64 crisis and the withdrawal of the Turkish Cypriots from the government and all aspects of the state structure. It is also important to note that many Turkish Cypriots withdrew into enclaves. Most Greek Cypriots saw this action as indicative of Turkish designs for partition. Most Turkish Cypriots, on the other hand, saw this as an indispensable move for their own security.⁴

In his Report in 1965 the UN special representative of the Secretary General of the UN, Galo Plaza, stated that there is no geographical basis for a federal solution to the Cyprus problem.⁵ This was because the Turkish-Cypriot population at the time was more or less evenly distributed throughout the island. However, Ankara and the Turkish-Cypriot side did not accept the philosophy and the recommendations of the Report. Greek Cypriots believed that the Turkish side already entertained ideas and positions the implementation of which would have enhanced the forcible exchange of population and the disruption of the socioeconomic life of the country.⁶ On the other hand, Greek Cypriots failed to comprehend the importance of economic measures the implementation of which could have been a major step towards the promotion and consolidation of an integrated society.

It should be noted that the period 1960-1973 was characterized by robust economic growth and development as well as social transformation.⁷ By 1973 Cyprus was no longer a predominantly agrarian society. A sizable service sector had been created, there was modest urbanization and tourism was on the rise, while the average annual growth for this

³ This is a major point raised by Turkish Cypriots in several interviews.

⁴ B. O'Malley and I. Craig, *The Cyprus Conspiracy: America, Espionage and the Turkish Invasion*, op. cit., pp. 87-93. It is also indicative that the then Turkish-Cypriot leader Mr Kūçūk stated that "[T]here is no possibility of the Turkish community living with the Greek community again. There must be partition". See *Daily Express*, December 31, 1963.

⁵ G. Plaza, "United Nations Security Council, Report of the United Nations Mediator on Cyprus to the Secretary-General", Note by the Secretary-General, S/6253, 26 March 1965.

⁶ It could be argued that this was a major reason for the rejection of the G. Plaza Report, op. cit. For interesting reading see B. O'Malley and I. Craig, *The Cyprus Conspiracy: America, Espionage and the Turkish Invasion*, op. cit., especially pp. 87-93; Th. Ehrlich, *Cyprus 1958-1967*, op. cit. and Ch. Hitchens, *Hostage to History: Cyprus from the Ottomans to Kissinger*, (Verso Press, London/New York 1997).

⁷ D. Christodoulou, *Inside the Cyprus Miracle: Labours of an Embattled Mini-Economy*, op. cit.; A. Theophanous, "Economic Growth and Development in Cyprus 1960-1984", *Modern Greek Studies Yearbook* (vol. 7, 1991), pp. 105-132; D. Whitaker, "The Economy" in F. Bunge (Ed.), *Cyprus: A Country Study*, (Washington DC: The American University 1980), pp. 105-151.

period was in excess of 7%.⁸ However, Turkish Cypriots did not satisfactorily share the fruits of economic growth and development.⁹ While Turkish Cypriots complained of discrimination, Greek Cypriots argued that the Turkish Cypriots' relative lack of development was the outcome of the secessionist policy of their leadership and of Ankara.¹⁰

The impressive socioeconomic record in conjunction with other factors led to the disenchantment of the majority of Greek Cypriots with the cause of *enosis* (union with Greece).¹¹ Thus, in this period, the two communities might have achieved a settlement on the basis of a unitary state with elements of local and communal self-administration on issues of low level politics. Indeed, on two occasions it seemed that there would be a fruitful outcome from the enhanced intercommunal negotiations (one of which was in July 1974, before the coup and the invasion).¹²

Nevertheless in July 1974 the headlines of the Greek-Cypriot newspapers were not dealing with the prospect of an imminent agreement with the Turkish Cypriots. Instead, it was the clash between Makarios and the Greek Junta which was making news. With the military coup of the Junta on July 15, 1974 and the Turkish invasion on July 20, 1974 the course of Cyprus's history changed dramatically.¹³ Whether or not this change is of permanent nature remains to be seen. What is certain is that a golden opportunity for an integral Cyprus based on the model of a unitary state was missed.

Perspectives on the High Level Agreements

With the events of the summer of 1974 and what followed, a new situation was created in Cyprus. In addition to the human tragedy, certainly there was severe socioeconomic dislocation and disruption as well as a new *de facto* political state of affairs. This included the forcible expulsion of thousands of Greek Cypriots from their ancestral land and the gradual transfer of all Turkish Cypriots to the occupied part of Cyprus.¹⁴ In February 1975, the Turkish-Cypriot leader Rauf Denktash declared the occupied northern part of Cyprus as the "Turkish Federated State of Northern Cyprus".¹⁵

⁸ Republic of Cyprus, Statistical Service, Statistical Abstract, various years.

⁹ For interesting reading see S. Panagides, "Communal Conflict and Economic Considerations: the Case of Cyprus", *Journal of Peace Research*, vol. 5, 1968, pp. 133-145; M. Attalides, "The Turkish Cypriots: Their Relations to the Greek Cypriots in Perspective" in M. Attalides (Ed.), *Cyprus Reviewed*, op. cit., pp. 71-97.

¹⁰ Retrospectively many Greek Cypriots understand that despite the Turkish designs developments could have followed a different course. It should be noted that N. Crawshaw, (*The Cyprus Revolt: An Account of the Struggle for Union with Greece*, op. cit.) adopts a very critical perspective on the Greek Cypriots.

¹¹ See M. Attalides, *Cyprus: Nationalism and International Politics*, op. cit.; K. C. Markides, *The Rise and Fall of the Cyprus Republic*, op. cit.

¹² See Gl. Clerides, *My Deposition*, vol. 3 (in Greek), (Alitheia Press, Nicosia 1990), pp. 193-243; M. Dekleris, *The Cyprus Question 1972-1974: The Last Opportunity* (in Greek), (Estia, Athens 1981), pp. 266-273; M. Christodoulou, *The Course of an Era: Greece, the Cypriot Leadership and the Cyprus Problem* (in Greek), (Ioannis Floros, Athens 1987), p. 623.

¹³ Ch. Hitchens, *Hostage to History: Cyprus from the Ottomans to Kissinger*, op. cit.

¹⁴ Ch. Hitchens, *Hostage to History: Cyprus from the Ottomans to Kissinger*, op. cit.; B. O'Malley and I. Craig, *The Cyprus Conspiracy: America, Espionage and the Turkish Invasion*, op. cit. For a Turkish-Cypriot perspective see P. Oberling, *The Road to Bellapais*, (Social Science Monographs, Boulder, New York 1982).

¹⁵ See C. H. Dodd, "From Federated State to Republic 1975-1984" in C. H. Dodd (Ed.), *The Political, Social and Economic Development of Northern Cyprus*, (Eothen Press, Huntingdon 1993), pp. 103-135.

In the meantime there was new thinking about how to go forward with a final solution to the Cyprus problem. Initially the Greek Cypriots were discussing the prospect of a multi-canton federation. The Turkish-Cypriot side immediately revealed its preference for what came to be known as “a bizonal bicomunal federation”. The high level agreements of 1977 and 1979 entailed a very different approach than what was ever discussed before 1974.¹⁶

There are two major points that must be stressed in relation to the high level agreements. First, for the Turkish-Cypriot side these agreements very nearly met their maximalist position, while for the Greek Cypriots they were (and have ever since been) considered to represent a very painful concession. Second, and perhaps even more seriously, the mainstream interpretation of what was actually agreed in the high level agreements was diametrically different in each community.¹⁷

Different interpretations and perspectives did not only revolve around the size of the area that should be under Turkish-Cypriot administration; for Makarios and the Greek Cypriots the right of property, the right of return of the refugees to their homes and the right of settlement of all Cypriots throughout the island were (and essentially remain) inalienable. For the Greek Cypriots it was logical to demand their properties back, and the Turkish Cypriots' demand to live in an area under their own administration could be satisfied without violating the rights of Greek Cypriots. The Republic of Cyprus could undertake to construct on state land new homes for Turkish Cypriots living on Greek-Cypriot property. Arrangements could be made so that even if all Greek Cypriots returned under Turkish-Cypriot administration, there would still be a Turkish-Cypriot majority in the northern part of Cyprus.¹⁸

The Turkish-Cypriot positions on these issues were diametrically opposite. Denktash was clear: there would be “global” exchange of properties and compensations; the region administered by each community would be ethnically homogeneous, if possible.¹⁹

¹⁶ It is a point often missed by international observers that the shift from the discussion of a unitary state to avoid partition, to the concept of a bizonal bicomunal federation was a very painful concession by Greek Cypriots because it entailed the acceptance of certain “facts on the ground” created by Turkey’s invasion and occupation of the northern part of the island. Besides, the vast majority of Greek Cypriots never saw it as an ideological, or ideal, objective. The Greek-Cypriot leadership saw it as a necessary step to reestablish the unity of the country. What is even more important to note is that more than three decades after these agreements, there is still a great intercommunal and intracommunal gap in relation to the interpretation of what was agreed. For interesting reading see C. Palley, *An International Relations Debacle: The UN Secretary-General’s Mission of Good Offices in Cyprus 1999-2004*, Hart Publishing, Oxford and Portland, Oregon, 2005; F. Mirbagheri, *Cyprus and International Peacemaking*, (C. Hurst & Co., London 1998).

¹⁷ In sum for Greek Cypriots this entailed the transformation and not the dissolution of the Republic of Cyprus. For Turkish Cypriots it involved a new partnership with the creation of a new state. Furthermore, for the Turkish side the two states would be close to ethnically homogeneous. See the positions of the two sides as they had evolved by 1999 in Appendix D: “An Assessment of the Positions of the Two Sides at the Beginning of the Process during the Autumn of 1999 and of Annan Plan V (31st March 2004)”, in A. Theophanous, *The Cyprus Question: The Challenge and the Promise*, (Intercollege Press, Nicosia 2004), pp. 199-205.

¹⁸ From discussions with the late M. Christodoulou, close associate (who served for many years as government spokesman) of President Makarios as well as other veteran politicians including V. Lyssarides and Ch. Veniamin. See also A. Theophanous, “Which bizonal bicomunal federation” (in Greek), *Politis* newspaper, 30/9/2007, pp. 37-39.

¹⁹ See proposals of the Greek-Cypriot community (1989), “Outline Proposals for the Establishment of a Federal Republic and for the Solution of the Cyprus Problem”, (January 30, 1989), and proposals by the then Turkish-Cypriot leader R. Denktash in M. Moran, *Sovereignty Divided*, (3rd ed.), (CYPER, Ankara 1999), p. 242 (see also Appendix C). See also “An Assessment of the Positions of the Two Sides at the Beginning of the Process during the Autumn of 1999 and of Annan Plan V (31st March 2004)”, in A. Theophanous, *The Cyprus Question: The Challenge and the Promise*, op. cit.

Furthermore, the Turkish-Cypriot interpretation of the new state structure had multidimensional and complex implications. In essence the central government would be very weak and the source of power would be the two ethnically homogeneous entities; these were to be described as “constituent states” in Annan Plan V in 2004.²⁰

Obviously such an arrangement as visualized by the Turkish-Cypriot side would make it difficult to have one economy, one society and one state. The strict, almost absolute, bizonality clauses demanded by the Turkish-Cypriot side negate the idea of a unified economy.²¹ Yet within the same philosophical perspective, the Turkish-Cypriot side would demand convergence of living standards – without an integrated economy and without the free flow of factors of production. And there was no talk about convergence of productivity levels.²²

There were different perspectives on the decision-making processes too. The Turkish-Cypriot demands stressed the concept of political equality in all aspects.²³ That meant that no major decision could be taken without Turkish-Cypriot consent. It also meant that Turkish Cypriots wanted a 50-50 representation in the central government. And the idea of rotating presidency was put on the table by the Turkish-Cypriot side.²⁴

For the Greek Cypriots this was too much. It was one thing for the Turkish Cypriots to have autonomy in the region under their administration; it was another to demand a 50-50 share²⁵ in the central government, a demand that only fed Greek-Cypriot long-standing fears of Turkish-Cypriot domination by Ankara. Greek Cypriots agreed that there could be effective Turkish-Cypriot participation in government, but this did not translate to participation on a 50-50 basis.²⁶ Greek Cypriots stressed the supremacy of the central government in contrast to the Turkish Cypriots’ position that most power should emanate from the two zones which moreover were regarded not so much as zones but as political entities of equal, almost sovereign status.

It is clear that the differences of the two sides ran very deep. If we also take into consideration political and geostrategic considerations then it is no surprise that there was

²⁰ United Nations, *The Comprehensive Settlement of the Cyprus Problem*, (fifth version 31 March 2004). <<http://www.un.org/Docs/sc/sgrep04.html>>

²¹ Indeed such clauses were included in Annan Plan V; for example, there were serious limitations to Greek Cypriots residing in the Turkish-Cypriot constituent state as well as to their rights regarding acquiring property.

²² There was no discussion on these vital issues. Discussions never touched the depth and the substance of what bizonal bicomunal federation entails in relation to economic issues.

²³ It may be interesting to see the formulation of the Turkish positions in the UN documents in the early 90’s see United Nations, *Set of Ideas (for the solution of the Cyprus Problem)*, S/24472, August 21, 1992; United Nations, *Summary of the Current Positions of the two sides in Relation to the Set of Ideas*, S/24472, 11 November 1992; see also the relevant “Proposals of Turkish-Cypriot leader R. Denktash for the Solution of the Cyprus Problem August 31, 1998”, Appendix C.

²⁴ This idea eventually led to the suggestion for a Presidential Council in the Annan Plan. Indeed, it should be noted that the philosophy of the Annan Plan was such that the interpretation of the term ‘political equality’ was nearer to that of the Turkish side.

²⁵ For example, besides equal representation in the Senate and the Supreme Court, Turkish Cypriots demanded rotation presidency.

²⁶ See proposals of the Greek-Cypriot side, “Outline Proposals for the Establishment of a Federal Republic and for the Solution of the Cyprus Problem”, op. cit.

no breakthrough over the years. Suffice it to say that Turkish Cypriots view the Republic of Cyprus as a Greek-Cypriot state and would thus prefer “a new partnership” involving a “new state of affairs”. Greek Cypriots, however, want any solution to take place within the framework of the internationally recognized Republic of Cyprus. Furthermore, Greek Cypriots view any potential constitutional arrangement not only as a tool for coexistence – but also through the geopolitical dimension of the perceived objectives of Ankara over Cyprus. Thus, the silent majority of Greek Cypriots saw the Turkish-Cypriot ideas for a solution as entailing “control in the north” and “a partnership arrangement in the south”. This was/is worse than partition!²⁷

Efforts of the International Community and the Annan Plan

Soon after the high level agreements the conventional wisdom and positions in relation to a solution of the Cyprus problem evolved into what was described as a bizonal bicomunal federation. Several factors contributed to this. First, the international community was trying to find common ground between two diametrically different positions. Then we must consider Turkey’s greater international weight in relation to that of Cyprus. This imbalance of power led Greek Cypriots to feel that the synthesis and the proposals put on the table primarily reflected Turkish positions.²⁸

Greek Cypriots never accepted the Turkish philosophy of bizonal bicomunal federation. They did not even feel comfortable with the way Makarios had interpreted it, but eventually they accepted it. President George Vassiliou tried to codify the positions of the Greek-Cypriot side into what came to be known as the Greek-Cypriot proposals of 1989.²⁹ These proposals accepted that Turkish Cypriots would constitute a majority in the area to be administered by the Turkish-Cypriot community.

The Greek-Cypriot proposals had specified several aspects of what could constitute a bizonal bicomunal federation. However, the UN mediation had to also incorporate the Turkish-Cypriot positions. The eventual UN positions reflected an attempt at a synthesis of ideas.

²⁷ This has been put forward by politicians like the late S. Kyprianou, T. Papadopoulos and V. Lyssarides. It has also been put forward by several academics and journalists alike. For example, Y. Valinakis, “A Bold Proposition for Cyprus”, *Kathimerini* (Athenian daily), September 24, 1989; A. Theophanous, *European Cyprus: Constitutional Structure Economy and Society, Accession and Solution Scenarios* (in Greek), (I. Sideris, Athens 2002), especially pp. 195-203; St. Lygeros, *On the Brink of Extinction* (in Greek), (Livanis, Athens 1993); D. Constantakopoulos, *The Seizure of Cyprus* (in Greek), (Livanis, Athens 2004). It should be clarified that the analysis put forward does not call for partition. Instead, it indicates that the particular philosophy entailed in the “mainstream version” of bizonal bicomunal federation may be worse than partition.

²⁸ It would be interesting to see S. Avineri, “A Deeply Flawed Peace Plan for Cyprus”, *Jerusalem Post*, 29 February 2004, and M. A. Birand, “Only independence would be better”, *Turkish Daily News*, 1 April 2004.

²⁹ Greek-Cypriot side, “Outline Proposals for the Establishment of a Federal Republic and for the Solution of the Cyprus Problem”, op. cit.

When the Ghali Set of Ideas was put forward in the summer of 1992³⁰ the Turkish-Cypriot side rejected it.³¹ President Vassiliou accepted it as a basis for negotiations, out of which there would eventually be a “fair settlement”. This became the major issue in the presidential elections of 1993. Glafcos Clerides, who was very critical of the Ghali Set of Ideas, was successful in winning the elections with the contribution of the late Spyros Kyprianou (then leader of the Democratic Party) and the tacit approval of Vasos Lyssarides (then leader of the Socialist Party).³²

It took time for the international community to seriously invest again in a coordinated effort to address the Cyprus question. This became possible as greater interests and stakes were involved with Turkey’s European ambitions.³³

The fifth version of the Annan Plan (Annan Plan V) constituted the climax of the efforts of the international community to address the problem comprehensively.³⁴ The outcome of the referenda of April 24, 2004, 75,8% rejection by Greek Cypriots and 64,9% approval by Turkish Cypriots (and the settlers who voted), may well be indicative of an imbalanced plan.³⁵

Before and After April 2003

To understand the post-April 2003 situation, we must consider it in all its dimensions and in light of its potential implications for developments in Cyprus. We should recall that the majority of Turkish Cypriots had, by the spring of 2003, already repeatedly expressed their preferences in favour of the Annan Plan despite the intransigence of the then Turkish-Cypriot leader Rauf Denktaş.³⁶

The Annan Plan satisfied most of the Turkish-Cypriot concerns: there were provisions for a new partnership, a Presidential Council with rotating presidency and Turkey’s guarantees. More importantly, strict bizonality and the bicommunality of the federal state were entrenched.

³⁰ It may be interesting to see the formulation of the Turkish positions in the UN documents in the early 90’s: see United Nations, Set of Ideas (for the solution of the Cyprus Problem), S/24472, August 21, 1992. It would also be interesting to see United Nations, Summary of the Current Positions of the two sides in Relation to the Set of Ideas, S/24472, 11 November 1992.

³¹ It is essential to acknowledge that the philosophy of the Ghali Set of Ideas was similar to that of the Annan Plan; it incorporated ‘political equality’, entrenched bizonality and bicommunality and maintained the system of guarantees with the participation of Turkey. R. Denktaş rejected this plan. A few years later he was consistent in this position as he also rejected the Annan Plan. Denktaş would support complete separation and a very loose confederal arrangement. It should be noted though that in such an arrangement no major decision can be made in relation to foreign policy and security issues without the consent of the Turkish side.

³² For interesting reading in relation to this period see St. Lygeros, *On the Brink of Extinction* (in Greek), op. cit.; see also Greek-Cypriot press during February 1993.

³³ See S. Sayari, “The US Policy on Turkey’s Quest for EU Membership”, A. Theophanous, “Euro-Turkish Relations and Cyprus”, in N. Goren and A. Nachmani (Eds), *The Importance of Being European: Turkey, the EU and Middle East*, (Conference and Lecture Series 4, The Hebrew University of Jerusalem, Jerusalem 2007), pp. 78-85 and 32-50 respectively.

³⁴ United Nations, “The Comprehensive Settlement of the Cyprus Problem” (fifth version of the Annan Plan: Annan Plan V), as submitted on March 31, 2004. <<http://www.un.org/Docs/sc/sgrep04.html>>

³⁵ For interesting reading, see S. Avineri, “A Deeply Flawed Peace Plan for Cyprus”, op. cit.; M. A. Birand, “We may miss the Annan Plan (in Turkish), op. cit.; M. A. Birand, “Only independence would be better” (in Turkish), *Turkish Daily News*, 1 April 2004.

³⁶ There were several demonstrations in the northern part of Cyprus in favour of the Annan Plan and reunification: *The Guardian*, “Turkish Cypriots rally for UN plan” (January 15, 2003) and “Turkish Cypriots say enough” (January 18, 2003); *Reuters*, “Enough, nobody believes you...’ Turkish Cypriot Rally Calls for Denktaş to Quit”, 27 December 2002. See also H. Smith, “Cyprus Turks turn against their leader”, *The Guardian*, December 19, 2003.

In return, Greek Cypriots would gradually regain a small portion (about 7,5%) of the land occupied in 1974. It also provided for a solution to the Cyprus problem and simultaneous accession to the EU of a reunited island. For those who had prepared it as well as for its supporters, it was a unique promise for a new era. That could mean more jobs, more opportunities, openness, and, moreover, reunification of Cyprus and reintegration of the Turkish-Cypriot community with the rest of the world. From their perspective, the overwhelming influence of Turkey would also be reduced.

It should be taken into consideration that by the beginning of 2003 there was a huge socioeconomic gap between the government-controlled areas of the Republic of Cyprus and the occupied northern part. GDP per capita was in the ratio of almost 1:4. And even more depressing for the Turkish Cypriots were the limited future prospects. The Turkish-Cypriot society and economy did not offer many opportunities and dependence on Turkey was overwhelming. This was a major reason for Turkish-Cypriot emigration, especially of the younger generations.³⁷

Nevertheless, more and more Turkish Cypriots were continuing on to higher education and had higher expectations. The structure of the economy was based on a statist model with a huge public sector. Only the tertiary education sector was booming, but even that had its shortcomings and dependencies.³⁸

On the other hand Greek Cypriots were prospering. Certainly, the economy of the government-controlled areas had its own shortcomings but it enjoyed sustainable growth and standards of living were constantly improving. Furthermore, despite particular problems, expectations for the future were bright. The general picture was very positive and neither shortcomings nor structural problems were widely discussed. The Republic of Cyprus was also preparing for accession to the EU. The multidimensional gap – real and perceived – between the two sides of the green line kept growing.

Turkish Cypriots saw the Greek-Cypriot leadership taking bold steps toward the Annan Plan while their leader, Rauf Denktash, and Turkey as well, pursued their familiar policy of intransigence. In the meantime the potential force of the Greek-Cypriot activists who had serious reservations about the Annan Plan was ignored. During the period March 9-11, 2003 the UN Secretary General made a last effort to push for a solution or at least keep the process alive. But again it collapsed. And the blame was put on Rauf Denktash and the Turkish side in general.³⁹

³⁷ See A. Theophanous and Y. Tirkides, "The Cyprus Economy in Perspective: an Analysis of Growth and Structure" in A. Theophanous and Y. Tirkides (Eds), *Accession to the Eurozone and the Reunification of the Cyprus Economy*, Intercollege Press, Nicosia 2006, pp. 19-81, (especially pp. 63-81); M. Watson and V. Herzberg, *The Wolfson Cyprus Group Conference*, "Sustainable Economic Development in Cyprus: Towards Economic Convergence and Reunification: The Case of the Northern Part of Cyprus", *Macroeconomic and Financial Frameworks*, May, 2005.

³⁸ W. Noë and M. Watson, "Convergence and Reunification in Cyprus: Scope for a Virtuous Circle", *ECFIN Country Focus*, vol. 2, no. 3, 2005, p. 3.

³⁹ See D. Hannay, *Cyprus: The Search for a Solution*, (I.B. Tauris & Co. Ltd, London 2005), pp. 213-219; C. Palley, *An International Relations Debacle: The UN Secretary-General's Mission of Good Offices in Cyprus 1999-2004*, op. cit., pp. 61-65.

In Athens, on April 16, 2003, the then President of the Republic of Cyprus Tassos Papadopoulos signed the Treaty of Accession to the EU. There was jubilation amongst Greek Cypriots. And there was distress and mounting pressures in the northern part of Cyprus against their leadership. There had already been several demonstrations in the previous months against Denktash and in favour of the reunification of Cyprus and its eventual accession to the EU.⁴⁰

Rauf Denktash, encouraged by Ankara, moved forward with a surprising step – a step which partly removed the obstacles to free movement on both sides of the green line.⁴¹ There were anticipated gains from this move:⁴²

- (a) Turkish-Cypriot pressure against the regime would be reduced;
- (b) international pressure on the “TRNC” and Turkey would be reduced; furthermore, the Turkish side in general would receive credit;
- (c) it was expected that this move would offer great socioeconomic benefits to the “TRNC” – as it did;
- (d) from a political perspective, the way that the relatively free mobility of persons was to be managed could influence the political landscape in relation to the form of the solution; in other words, the *status quo* would more or less be normalized, with some moderate adjustments.

What followed is indeed very interesting. But the most significant result, and one which is of fundamental importance, is that there have been thousands of crossings in both directions ever since.⁴³ Initially there was a mood of optimism and great emotion. Some people even made comparison with the fall of the Berlin Wall, although in the case of Cyprus there was no collapse of the regime.⁴⁴ On the contrary, what took place strengthened the regime.

From a socioeconomic and political perspective what was taking place seemed to erode one of the fundamental pillars of Turkish policy in Cyprus: namely that Greek Cypriots and Turkish Cypriots could not live together, making strict bizonality a necessity for Turkish Cypriots. Denktash had argued for years, among other things, that strict bizonality and if possible complete separation, was necessary for security reasons. Nevertheless, the reality (thousands of crossings each week without any incident) did not confirm Denktash’s hypothesis.

⁴⁰ See footnote 36.

⁴¹ Greek Cypriots were allowed to cross to the northern part of the island through a limited number of crossing points on condition that they showed passports (later this was changed to ID) and Turkish Cypriots were allowed to cross freely to the government-controlled areas by showing an ID card.

⁴² A. Theophanous, *The Cyprus Question: The Challenge and the Promise*, op. cit., pp. 55-60.

⁴³ C. Webster, Chr. Christophorou, Chr. Panayidou, "Cypriots and their Holidays in 2003 and Greek Cypriot Opinions and Behavior on Visits to the Occupied Areas", CYMAR Market Research, November 2003. See also Appendix D.

⁴⁴ D. Hannay, *Cyprus: The Search for a Solution*, op. cit., pp. 225-226.

From the perspective of public image it seemed that the Turkish(Cypriot) side had not only scored a major diplomatic and political point; it also took Greek Cypriots by surprise. The Cypriot government reacted rather clumsily; it seemed that there was no clear policy. Some officials encouraged the crossings, others discouraged them and the rest took a neutral stance and/or a position “that it was up to each individual how to act”. On April 30, 2003 the Cypriot government announced support measures for the Turkish Cypriots which included free medical care in public hospitals, access to official documents of the Republic of Cyprus (e.g. identity cards, passports), access to the labour market in the government-controlled areas, etc.⁴⁵

The measures were a step in the right direction. But they were poorly marketed to the world while at the same time the Turkish Cypriots had higher expectations. Nevertheless, despite problems and shortcomings, the crossings and the contacts were creating a new reality. The main tenet of Denktash’s policy, and Turkish policy in general – that the two communities could not coexist and that to avoid conflict they had to be separate – was undermined.

The socioeconomic repercussions were significant. Although it was reported that official bicomunal activities declined, intercommunal contacts were enhanced. And there were hopes for a brighter future. The economy of the northern part of Cyprus began to feel the multidimensional impact of the Greek-Cypriot injections. Greek Cypriots spent money in the northern part of Cyprus, while a growing number of Turkish Cypriots obtained full-time or part-time jobs in the government-controlled areas.⁴⁶

Indeed it was a new era. And it was very clear that the philosophy of the Annan Plan had been surpassed by events and was not reflecting the current realities. Although the Cypriot government was not sympathetic to the philosophy of the Annan Plan it shied away from making bold steps. These could have included proposals for a new approach to the Cyprus problem in conjunction with the promotion of Confidence Building Measures (CBMs) which could lead to major socioeconomic gains on both sides and also create a new political atmosphere.⁴⁷

⁴⁵ For detailed reading see the web page of the Public Information Office of the Republic of Cyprus, www.pio.gov.cy

⁴⁶ It should be noted that at the beginning of the partial lifting of the restrictions to free movement it was estimated that almost 10.000 Turkish Cypriots acquired part-time or full-time jobs in the government-controlled areas. In the aftermath of 2005 numbers were gradually reduced. By the end of 2007 it was estimated that only around 6.000 Turkish Cypriots worked in the government-controlled areas. See research project entitled “*The Economic and Social Repercussions and Consequences from the Partial Lifting of Restrictions on the Freedom of Movement*” (in Greek), Cyprus Center for European and International Affairs, Nicosia December 2007. However, figures produced since then on the number of crossings (see Appendix D) as well as from the Department of Social Insurance suggest that, even with unregistered workers, the number never exceeded 7.000 full- and part-timers, and is probably around 6.000 today.

⁴⁷ Given the existing gap between the positions of the two sides and the need for a breakthrough, perhaps the adoption of CBM’s was the only way forward before 2004. See A. Theophanous, *The Annan Plan and the European Option* (in Greek), (Papazisis Press, Athens 2003), pp. 86-87, 95.

For the US, the UK and some other European powers, though, despite developments in Cyprus, there was a keen interest to see Turkey receiving a date for the start of accession negotiations. Cyprus was an obstacle and Turkey at the time was perceived as the party greatly responsible for the stalemate. Inevitably this was a stumbling block for Turkey.

It was under these circumstances that a new final effort to promote the Annan Plan was initiated. The mainstream Greek-Cypriot perception was that the ultimate objective of the Annan Plan on the part of the international community was to secure the Turkish(Cypriot) yes. If the Greek Cypriots also voted yes this would satisfy many objectives. If there was to be a NO vote, this should come from the Greek-Cypriot side. And Turkey would receive a date for the start of accession negotiations.⁴⁸

On April 24, 2004 Greek Cypriots overwhelmingly rejected Annan Plan V with a strong majority of 75,8%. At the same time Turkish Cypriots (and the settlers who voted) accepted it with a 64,9% majority. Notwithstanding the debate about the negotiations tactics of former President Papadopoulos, this diametrically opposite pattern of voting provides an indication of a seriously imbalanced plan.

The repercussions of the outcome of the referenda were rather serious.⁴⁹ The UN plan was put aside. The Greek Cypriots lost their moral high ground at least in the short-run. Many Turkish Cypriots felt rejected by Greek Cypriots. And Turkey was on its way to receiving a date for its accession negotiations with the EU. The Republic of Cyprus joined the EU on May 1, 2004 but was not in a position to pursue a policy demanding from Turkey a serious change on its Cyprus policy in return for obtaining a date for the start of accession negotiations at the time. And the island remained divided.

It is essential to note that there was a new atmosphere on the island. From a political, social and psychological perspective the two communities felt further apart again. Turkish Cypriots felt bitter and rejected. Greek Cypriots felt that Turkish Cypriots were very well aware of their rights but not of their obligations.⁵⁰ As already noted these rights included the right to free medical care. Suddenly the problem from the perspective of the international community was not the Turkish occupation of the northern part of Cyprus but rather “the isolation of the Turkish Cypriots”.⁵¹

⁴⁸ C. Palley, *An International Relations Debate: The UN Secretary-General's Mission of Good Offices in Cyprus 1999-2004*, op. cit; see also A. Theophanous, *The Cyprus Question: The Challenge and the Promise*, op. cit.

⁴⁹ The Turkish side was perceived as the one which changed its policy and voted for peace. On the contrary, Greek Cypriots who had been asking the international community to assist/help to promote reunification voted NO. President Papadopoulos, Greek Cypriots and the Republic of Cyprus were under serious criticism the extent of which amounted to a presentation of issues and facts that took little account of Greek-Cypriot concerns and objectives. See for example “The Cyprus Stalemate: What Next?”, op. cit., Europe Report No. 171, *International Crisis Group*, March 8, 2006.

⁵⁰ This perception intensified after the partial lifting of obstacles to free movement. This was one of the findings of a research study entitled “*The Economic and Social Consequences and Repercussions from the Partial Lifting of Restrictions on the Freedom of Movement*”, op. cit. It should also be noted that this perspective often appears in the Greek-Cypriot press.

⁵¹ Immediately after the referenda of April 24, 2004 the then Secretary General of the UN Kofi Annan included this in his Report to the Security Council. On April 26, 2004 the EU General Affairs Committee expressed its determination “to put an end to the isolation of the Turkish-Cypriot community”. The US was also sympathetic to this view. <<http://www.un.org/News/Press/docs/2004/sc8116.doc.htm>>

It was under these new circumstances that a massive and unprecedented exploitation of Greek-Cypriot properties in the northern part of Cyprus started.⁵² At the same time Turkish Cypriots claimed their rights in the Republic of Cyprus which was now a member of the EU. By the end of 2007 a total of 81.089 Turkish Cypriots had obtained the identity card of the Republic of Cyprus; furthermore, 51.391 passports and 93.367 birth certificates were issued for Turkish Cypriots.⁵³

In the period immediately after April 2003, it was estimated that almost 10.000 Turkish Cypriots were working on a full-time or part-time basis in the government-controlled areas although, as already noted, new data suggest that the number may have been closer to 7.000. This number has probably also decreased, as well as the daily crossings of people from both sides.⁵⁴ Despite the substantial reduction of crossings their economic impact is still important. By the end of 2007 income per capita in the northern part of Cyprus was about 50% of the corresponding level in the government-controlled areas.⁵⁵

Some Lessons Learned

There is no doubt that a very serious gap exists between the two sides in relation to the various aspects of the Cyprus problem. Moreover, there has not been adequate preparation of the public about the fundamental pillars of a federal arrangement.⁵⁶ Apart from the negotiation teams of the two sides, it is essential that we have an engagement of elites at different levels as well as a meaningful discussion. In this regard it has been observed that although there have been intercommunal exchanges and various networks of cooperation, there has not been a proper debate between the elites of the two sides that included the involvement of the general public. Instead there has been very little intercommunal debate which in any case was never structured.

By definition, in a modern state there must be provisions for comprehensive policy which would address issues of economic growth, balanced and sustainable development, creation of job opportunities, social policy and so on. Unfortunately, economics was not amongst the primary issues of preoccupation in relation to the Cyprus problem in the past.

The Annan process and its eventual outcome has shown that for any plan the constructive engagement of the public is necessary. In this regard if the accepted goal is a

⁵² The fact that property that Greek Cypriots were forced to abandon after the invasion of 1974 remained Greek-Cypriot titled has been established/confirmed by the case-law of the European Court of Human Rights in *Loizidou Vs Turkey* among others. Thus the sale and development of Greek-Cypriot land was and remains unlawful.

⁵³ From the Ministry of Interior of the Republic of Cyprus. <www.moi.gov.cy>

⁵⁴ This has been the outcome of a very difficult political environment. In relation to the crossings see Appendix D.

⁵⁵ For more details see M. Watson, "Growing Together? – Prospects for Economic Convergence and Reunification in Cyprus", GreeSE Paper No. 7, Hellenic Observatory Papers on Greece and Southeast Europe, *The London School of Economics and Political Science*, (London, October 2007).

⁵⁶ This was a point admitted by the new President Demetris Christofias, at a press conference on March 19, 2008.

federal arrangement then by definition the two sides must exhibit additional consideration of the sensitivities of each other.

Furthermore, it seems that there were many issues that were rather avoided. It is understood that nation-states must have policies in relation to social security systems, national health programmes and so on. This was not part of a serious debate. Yet, these are very serious issues which must be addressed.

In the aftermath of April 2003 there has been an opportunity for many more contacts and networks of cooperation. What is essential to note is that despite a heavy political climate these relations have been sustained, albeit to a limited extent.

Understandably, in order to move forward there are certain essential internal and external preconditions that must be met. This study aspires to contribute to a meaningful debate on the internal aspects of the issue with a focus on economic matters. Perceptions are important, regardless of how valid or invalid they might be. Do we have a chance for a meaningful breakthrough? It is possible, but certainly not obvious. In spite of recent progress, the overall state of affairs on the ground and at the level of perceptions is such that only very limited optimism may be justified.⁵⁷

⁵⁷ It remains to be seen whether the electoral victory of Demetris Christofias in the Presidential elections of February 2008 would change the overall climate and lead to a breakthrough.

II. THEORETICAL FRAMEWORK AND THE EXAMINATION OF FOUR SPECIFIC SCENARIA

The Major Economic Issues

Most discussions of the Cyprus problem have focused almost exclusively on security, constitutional, political and legal matters. The focus of this study is on economic issues; the above-mentioned dimensions will be discussed to the extent that they influence the economic issues under consideration.

In any modern state economic factors and considerations are of primary importance. If there is steady and balanced growth and development the objective of a normal political process is served. Understandably in the case of Cyprus, a country that has been *de facto* divided since 1974, the broad economic dimensions are of particular importance.

Before we briefly address the tenets of economic policy, their significance and implementation, it is vital to recall that in the case of Cyprus, the issue of property arrangements in relation to a solution must be addressed fairly and constructively.¹ Indeed, this is perhaps one of the thorniest issues. Over time the Turkish-Cypriot position revolved around the principle of a “global” exchange of properties and compensation.² In contrast, Greek Cypriots emphasized restitution.³

In relation to the specific property arrangements and eventually the final settlement itself, the right to acquire and hold property throughout the island is of particular importance to Greek Cypriots. The Greek-Cypriot position is that, if bizonality is to be secured and entrenched in the strictest sense, the right to hold property throughout the island will be curtailed. Besides the political dimensions, in essence these two opposite philosophies of property arrangements are of vital economic importance; and they involve both static and dynamic effects and repercussions. The major question is whether or not a compromise between these two philosophies can be found.

Understandably, the issue of the three fundamental freedoms – freedom of movement, freedom of settlement, and the freedom to hold property throughout the island – are

¹ For interesting reading see A. Gürel and K. Özersay, *The Politics of Property in Cyprus: Conflicting Appeals to “Bizonality” and “Human Rights” by the Two Cypriot Communities*, PRIO Cyprus Centre, Report 3/2006, International Peace Research Institute, (Oslo (PRIO), 2006).

² *Ibid.*, p. 2.

³ *Ibid.*

important. Capital mobility may also be addressed within the framework of the three fundamental freedoms. It is essential to understand that the particular model of a solution will have a critical impact not only on the outcome of these specific issues but also on the process of economic and social life in Cyprus as a whole.

Fiscal policy – both the expenditure and the taxation aspects – is of particular importance as well. There is not one specific formula that should be pursued; nevertheless, there are specific requirements that obviously should be met. In this regard it should be noted that Cyprus as a member of the Eurozone should abide by certain criteria, including the level of the budget deficit and of the public debt.⁴

There are different aspects that must be addressed such as the role of the central government and the two regional administrations. There are different implications and responsibilities with each particular fiscal structure that will be arranged. Perhaps the major issue to be addressed is whether or not the central government will have a primary role in formulating economic policy.

Furthermore, it should also be noted that traditionally there have been some theoretical misconceptions about fiscal policy; more specifically, fiscal policy was seen only as a matter of surpluses and deficits. This dimension is important, but it is not the only one. On the contrary, fiscal policy may create or at least influence incentives and disincentives. And it can also have a serious impact on short- and long-run growth patterns and on development in general.⁵

Another issue of particular importance is the legal framework of the financial system as a whole. In relation to this, Cyprus's accession to the EU and, since January 1, 2008, the introduction of the single currency, the euro, have clear implications. Monetary policy is determined by the European Central Bank (ECB) in the context of the European system of Central Banks. At the same time bank regulation and control are subject to particular directives. Increasingly the role of the ECB in regulation and supervision issues is becoming more important. Consequently, monetary policy implementation and bank supervision cannot be fragmented. Rather they must apply universally in the national context.

Developmental objectives are essential to any country. In the case of Cyprus this assumes special significance given the *de facto* division of the country and the different patterns on which the country as a whole has evolved. In the case of an agreed solution it

⁴ In relation to the challenges that Cyprus has to address as a member of the Eurozone see Y. Tirkides, "The Challenges of Accession to the Eurozone and the Reunification of the Cyprus Economy", "Conditions and Prerequisites for the Accession of the Cyprus Economy to the Eurozone and its Reunification" and A. Theophanous and Y. Tirkides, "Summary, Conclusions and Recommendations", in A. Theophanous and Y. Tirkides (Eds), *Accession to the Eurozone and the Reunification of the Cyprus Economy*, (Intercollege Press, Nicosia 2006), pp. 83-107, 181-214, 215-253 respectively. It should also be noted that this issue was also addressed during a seminar organized by The Ministry of Finance of the Republic of Cyprus, entitled *Challenges inside the euro area: Life after 1/1/2008*, on Friday, November 9, 2007.

⁵ For interesting reading see R. W. Boadway and D. E. Wildasin, *Public Sector Economics* (2nd ed.), (Little, Brown and Company, Boston / Toronto 1984) and A. Drazen, *Political Economy in Macroeconomics*, (Princeton University Press, Princeton, New Jersey, 2000), especially pp. 675-733.

is expected that there should be a reconstruction plan which ought to contribute to the bridging of the socioeconomic gaps between the two communities. Again the form and the content of a solution will make a difference.

One of the issues that did not receive its fair share of attention in the past is that of the Social Security Fund and related policies. The question is whether there will be one, two or three Social Security Funds in any future settlement. Naturally this will influence the related set of social policies. Again each particular model of a solution involves a different outcome.

Economic policy also entails issues such as competition as well as many other issues of concern for everyday life and how they will be determined. In this regard one could mention the position and the role of the local administrative units. Again the particular outcome in relation to the form of settlement (or non-settlement) of the Cyprus problem will have an impact on this. Ironically, it should be remembered that this particular theme was one of the reasons which led to the 1963 crisis. Perhaps it was not fully understood, in the lengthy discussions about constitutional and legal issues, that particular constitutional and institutional provisions have their own impact on economic issues and variables.

In sum, it is essential to understand that the particular form of settlement, or the lack of it, will influence critically all these economic variables and the economy as a whole. It should also be noted that the current stalemate has already had, and continues to have, a great socioeconomic impact.⁶

There are other issues that must be examined as well. The question of the settlers, for instance, comprises political as well as practical dimensions.⁷ The two extreme perspectives are that, on the one hand, "all settlers must go" and on the other "all settlers stay". A related question, which has already been posed, is who is a settler and who is not.⁸

Furthermore, the issue of immigration is of utmost importance and must be addressed accordingly. It is not only the concern of Greek Cypriots about the further inflow of people from Turkey. It is also an issue for the EU. Naturally in a unified state the responsibility for immigration policy lies with the central government. Within this framework addressing the issue of foreign workers is also an important chapter. Naturally this should also be in the domain of the central government.

In Cyprus tourism is a critical sector. Within the framework of a solution the issue of a coordinated policy must be addressed. Indeed, it would not be rational if the constitutional arrangements were such that Cyprus would have to implement two or even three tourist strategies.

⁶ This is widely acknowledged. For example, see "Cyprus: Reversing the Drift to Partition", Europe Report No. 190, *International Crisis Group*, January 10, 2008, especially pp. 15-19.

⁷ The mainstream Greek-Cypriot position is that settlers constitute a security issue and must withdraw accordingly. See Greek-Cypriot side, "Outline Proposals for the Establishment of a Federal Republic and for the Solution of the Cyprus Problem", (January 30, 1989).

⁸ See M. Hatay, *Beyond Numbers: Inquiring into the Political Integration of "Turkish Settlers" in Northern Cyprus*, (Nicosia, PRIO Report, April 2005).

It is pointed out that the list of issues raised so far is not exhaustive. Indeed, there are issues involving all aspects of public life; the environment, education policy, health, consumer protection and so on. Thus, what is important to understand is that politics will affect all these issues. Indeed, given the sustained division, such an impact is already being exerted in a negative manner.⁹

Constitutional Arrangements and Economic Structure

Little or no attention has been given to the relationship between constitutional arrangements and economic structure and the potential implications.¹⁰ It is essential to briefly define (or rather describe) what economic structure entails and also assess its importance for economic activity.

The economic structure of a state comprises, among other things, the relationship between the public and the private sector, the legal framework that regulates economic activity, the pattern and level of public expenditures, the taxation system and the level of tax revenues. It also includes the decision-making process, the relations between government, employers and employees, and thus the overall business environment.¹¹

Economic structure also incorporates incentive and disincentive systems, as well as whether or not an economy entails distortions. For example, a major factor affecting these issues is the level of government spending as a percentage of GDP.¹² In this regard it can be pointed out that there is a particular ratio below or above which, more often than not, there will be inefficient outcomes.¹³

Naturally an efficient and flexible economic structure encourages economic progress; an inflexible and distorted economic structure will have negative economic repercussions. The former USSR is a pertinent example of an inflexible economic structure, which resulted in the collapse of the economic system and the Soviet Union.

Thus, from a philosophical and a theoretical perspective we can see that economic structure affects to a great extent economic activity and economic variables. Economic growth, investment, the level of unemployment, inflation, and how resources are allocated are affected. Given the importance of these variables, efforts must be made to influence the factors that impact on them.

⁹ For example, it is noted that the current abnormal situation is associated with the absence of a legal framework. In its turn, this has led to various complications including the illegal sale and exploitation of Greek-Cypriot property in the northern part of Cyprus and environmental excesses. It is interesting to note that the International Crisis Group Report "Cyprus: Reversing the Drift to Partition", Europe Report No. 190, op. cit., calls upon the Turkish-Cypriot authorities to end the exploitation of Greek-Cypriot properties (p. ii).

¹⁰ See A. Theophanous, *European Cyprus: Constitutional Structure Economy and Society. Accession and Solution Scenarios* (in Greek), op. cit.

¹¹ See J. Stiglitz and F. Mathewson (Eds), *New Developments in the Analysis of Market Structure*, (The MIT Press, Cambridge / Maastricht 1986). See also A. Theophanous, *The Significance of the Structure of Government Spending in Macroeconomic Models*, Doctoral Dissertation, (The Pennsylvania State University, University Park 1988), esp. p. 4.

¹² Indeed, the high level of public spending in the northern part of Cyprus is discussed in the World Bank Report, "Sustainability and Sources of Economic Growth in the Northern Part of Cyprus", Volume I: Economic Assessment, p. 32, June 8, 2006 (Poverty Reduction and Economic Management Unit Europe and Central Asia Region).

¹³ For excellent reading on the issue of the rise of public spending and the broader dynamics and implications, see V. Tanzi and L. Schuknecht, *Public Spending in the 20th Century*, (Cambridge University Press, Cambridge 2000).

In turn constitutional arrangements and political issues and factors have a great impact on economic structure and thereby on economic variables. It is implicitly understood that sometimes it is preferable to pay an economic price so as to achieve particular political objectives. Understandably a federal structure in a small country like Cyprus entails an economic cost because it will inevitably entail certain duplications. What must be considered is whether particular arrangements might create prohibitive costs.¹⁴

This risk of prohibitive costs does not imply that the federal model cannot be considered. However, it will be important to choose the most efficient model within the framework of the federal philosophy, one that allows economic initiative to flourish both among Turkish Cypriots and Greek Cypriots, as well as between them. Although ideas from other federal countries may be utilized, Cyprus must find its own path and its own political system.

There are additional issues that must be considered further. In an integrated society choices and options may be such that they lead to the best possible outcomes. In contrast, the greater the degree of segregation as an outcome of particular political options, the greater the social cost that is created. Assume, for example, that health-related issues become exclusively the domain of responsibility of the two regions, which are structured on strict bizonality guidelines. That implies that essentially, and more often than not, there would be hospitals functioning along ethnic lines. What happens if a citizen suffering from a particular illness would rather prefer to be treated in a specialized hospital or clinic or by a doctor on the other side?¹⁵

In essence, constitutional and political issues would affect the degree of integration and segregation. In its turn this would affect economic structure and, consequently, economic activity. Another complication may be created by the following scenario: assume that a Turkish Cypriot resides in the region under Turkish-Cypriot control and is employed for years in a business venture in the Greek-Cypriot region. At some point in time he loses his job; from where does he get unemployment benefits? Would that be a function of the central government or would it be the responsibility of the component states/regions?¹⁵

The objective of raising these issues is to create awareness of the great interrelationship between constitutional and political arrangements on the one hand and economic outcomes on the other. Perhaps if (common) socioeconomic goals are given higher priority and their implications are realized, that may also in its turn have an impact on the discussion of what a viable and functional settlement should look like.

¹⁴ For interesting reading see A. Drazen, *Political Economy in Macroeconomics*, op. cit., pp. 675-733. Within the framework of this discussion it is also important to assess the possibility of promoting the most efficient arrangements within particular parameters or even constraints.

¹⁵ A. Theophanous, *European Cyprus: Constitutional Structure Economy and Society. Accession and Solution Scenarios* (in Greek), op. cit., pp. 208.

The Economic Objectives of the Two Sides: Convergence and Divergence

It is important to assess the economic objectives of the two sides. Within this framework we may be able to examine whether or not there is consistency between political and economic objectives.

In relation to the economic dimension of the property arrangements and the three fundamental freedoms, Greek Cypriots have particular objectives the implementation of which would lead to an integrated society. As already noted, in principle Greek Cypriots would like to see the restitution of properties and the full implementation of the three fundamental freedoms, but they do understand the particular constraints as well as the realities on the ground and would agree to transitional periods. They also understand that in relation to property arrangements there are many cases which would make restitution difficult if not impossible. But the overall feeling is that once this principle is accepted as taking priority over others, then it is possible to deal with specific issues/cases and address them in pragmatic ways.

It is one issue to impose exchange of properties and compensations with ambiguities and uncertainties and it is another to accept the principle of restitution and, thereafter, move forward with property exchanges and compensation on a voluntary basis. This particular aspect deserves special attention.

Turkish Cypriots on the other hand philosophically believe that in principle "global" exchanges and compensations should take place. Embedded in this philosophy is the view that issues must be addressed within the perspective of the realities on the ground on the one hand and consolidating bizonality on the other.¹⁶

Obviously there is a sizable gap between the positions of the two sides. The challenge is to see whether there can be ways to bridge these differences.

Both Greek and Turkish Cypriots agree in principle that there should be convergence of the standards of living between the two communities. The challenge though is to examine, practically, how this can take place. From the perspective of economic theory we may note that an integrated economy which operates along the lines of a free market with a qualitative interventionist public approach may offer the best way to advance socioeconomic convergence.¹⁷ Greek Cypriots support an integrationalist model. Turkish Cypriots on the other hand support a model which in essence is based on segregation.

It is also important to note that the real and sustainable convergence of standards of living cannot be an outcome of grants by the relatively richer community. That does not

¹⁶ A. Gürel and K. Özersay, *The Politics of Property in Cyprus: Conflicting Appeals to "Bizonality" and "Human Rights" by the Two Cypriot Communities*, op. cit.

¹⁷ For very interesting and informative reading (including a very extensive reference list) see Chapter XIII, "The Political Economy of Regional Integration" in R. Gilpin, *Global Political Economy: Understanding the International Economic Order*, (Princeton University Press, Princeton and Oxford 2001), pp. 341-361.

mean that Greek Cypriots are not prepared to undertake their share of responsibilities in the process of reconstruction and economic convergence. People may be in a position to accept sacrifices if there is a good reason for them and if they are convinced that their money is not wasted.¹⁸ Supporting the reconstruction effort as well as the process of convergence within the framework of an integrated society is one issue; paying taxes to be given in the form of grants to an almost homogeneous Turkish-Cypriot state within the framework of a loose federation/confederation is another.

Positions on several issues vary from well-established positions to not so clearly defined perspectives. In addition, there are many issues over which there has only been little or no discussion.

In general Greek Cypriots have been supporting the concept of a strong central government while Turkish Cypriots prefer a rather weak central government and more power invested in the two component/constituent states. Yet it is questionable whether many Greek Cypriots and Turkish Cypriots are fully aware of the implications of their respective options/positions.

A strong central government implies a more activist role in the process of reconstruction and convergence of the standards of living. The alternative model implies that the role of the central government would be rather limited in these two objectives. Turkish Cypriots cannot expect almost full autonomy and grants from the central government for carrying out particular objectives. Greek Cypriots should also understand that a strong central government may imply higher taxes for them within the framework of an integrated society, at least in the short run. Other issues over which there has not been much discussion and thinking at the political level, include the Social Security Fund, social policies in general, competition and consumer protection.

It is also noted that participation in the Eurozone entails particular responsibilities on the part of Cyprus towards the EU. These include particular fiscal indicators – deficit, public debt – as well as the regulatory framework of the financial system as a whole. This implies that there must be a policy of coordination. Autonomy in issues of economic policy in the era of the Eurozone and globalization is likely to be out of context and, in the best case, of a limited nature. Moreover, Cyprus will have to pursue the challenge of real convergence with the Eurozone.¹⁹

¹⁸ For interesting reading see H. Brey, "The German Experience of Reunification and Useful Lessons for Cyprus" in A. Theophanous and Y. Tirkides (Eds), *Accession to the Eurozone and the Reunification of the Cyprus Economy*, op. cit., pp. 143-179. The author makes this specific point on p. 176.

¹⁹ A. Theophanous and Y. Tirkides, "Summary, Conclusions and Recommendations", in A. Theophanous and Y. Tirkides (Eds), *Accession to the Eurozone and the Reunification of the Cyprus Economy*, op. cit. It should also be noted that this issue was also addressed during a seminar organized by The Ministry of Finance of the Republic of Cyprus, entitled *Challenges inside the euro area: Life after 1/1/2008*, on Friday, November 9, 2007.

The New International Economic Environment, the European Union and Cyprus²⁰

Over time economic factors have been playing a very important role in the political life of every country as well as in international politics. Their importance has kept growing. Consequently, it would be a serious omission if for the purposes of this study we did not briefly consider the major characteristics of the new international economic environment as well as participation in the EMU and how they can potentially affect Cyprus.

We stress the advancement of the forces of globalization with an accelerated pace. This includes the vast expansion of financial flows, of services as well as of international trade. Inevitably this process did not leave any country or region in the world unaffected. The increase in the mobility of goods, services and people has also been affecting all aspects of life. There is more interdependence and in many cases more dependence.

There has also been a rise of expectations. This is due to the expansion of communication. It is not only tourism and the mass media. There have been indeed two sweeping changes: the internet and mass education. Inevitably these changes have also been affecting the concept of autonomy of sovereignty. In an interdependent world more emphasis is now inevitably given to networks of cooperation and efficiency.

Obviously this could not leave Cyprus unaffected. For example, the economy of the "TRNC" could not meet all the demand for jobs and opportunities. And it was not only the number of available job openings; it was also a matter of the quality of jobs. Thus, in the post-1974 period there were many Turkish Cypriots who emigrated for socioeconomic reasons.²¹

If we also look at other trends entailed in the new international economic environment and the participation of Cyprus first in the EU and, subsequently, in the Eurozone, it will be observed that undergoing changes in the economic structure will necessitate a new pattern of policies by the state as well as by private economic agents. For example, certain established practices and attitudes may have to be revisited. These include strikes in the essential services as well as working hours in the broad public and the banking sectors. Furthermore, productivity in all sectors of the economy must be improved drastically.²²

²⁰ See A. Theophanous, *European Cyprus: Constitutional Structure Economy and Society. Accession and Solution Scenarios* (in Greek), op. cit., especially pp. 87-111, 229-232.

²¹ It should be noted that the extent of Turkish-Cypriot (permanent) emigration and moreover the size of the Turkish-Cypriot population (excluding the settlers) residing in the northern part of Cyprus is debatable. According to the Statistical Service of the Republic of Cyprus thousands have left since 1974 and today only about 90.000 Turkish Cypriots reside in the northern part of Cyprus. On the other hand Turkish-Cypriot sources indicate different numbers. See also M. Hatay, "Is the Turkish-Cypriot Population Shrinking?", (PRIO Cyprus Centre, Nicosia 2007).

²² This was one of the major messages of the conference organized by The Ministry of Finance of the Republic of Cyprus, *Challenges inside the euro area: Life after 1/1/2008*, op. cit., Friday, November 9, 2007. The speakers were Marco Buti, Max Watson, Carlos Martinez, Jean Pisany-Ferry and Charles Wyplosz. Furthermore, see A. Theophanous and Y. Tirkides, "Summary, Conclusions and Recommendations", in A. Theophanous and Y. Tirkides (Eds), *Accession to the Eurozone and the Reunification of the Cyprus Economy*, op. cit., pp. 215-253. See also A. Theophanous, Y. Tirkides and Th. Pelagidis, "Cyprus' Accession to the Eurozone and the Reunification of the Island's Economy", *Südosteuropa Mitteilungen*, 48 Jahrgang, January 2008, pp. 74-89.

There are demographic developments which in conjunction with the advancements in medicine will require a rethinking about how scarce resources are allocated and utilized to address the needs of an aging population.²³ Likewise structural unemployment may also necessitate the training and retraining of people. This requires a comprehensive policy. In the case of Cyprus one of the clear implications is that the political, economic and social elites may have to think beyond the traditional communal perspectives.

A major characteristic of the current international environment is population mobility and the formation of multiethnic or multicultural cities and societies. Cyprus, despite its particular circumstances, is no exception. Already Cyprus and especially the government-controlled areas are experiencing these changes more intensely.²⁴ The implication is clear: the terms bicommunality and bizonality must be reevaluated and/or re-assessed.²⁵

We could also address the implications of Cyprus accession to the Eurozone. Naturally participation in the EMU and the adoption of the euro as the national currency entail particular obligations for each member state. This includes meeting particular requirements within the framework of the fiscal domain as well as the overall financial system. This implies that some form of coordination is necessary. In addition, Cyprus as a whole will have to address the issue of real convergence with the EU besides internal convergence (between the two sides).²⁶

The Euro as the National Currency and the Implications

In the aftermath of the invasion and the occupation of the northern part of Cyprus, Turkey effectively proceeded with an economic union with the occupied area. Effectively a monetary and customs union was implemented and the Turkish lira has since then been the official currency. Ankara also continues to cover a substantial part of the budget. Taking all relevant issues and factors into consideration the dependence on Turkey is overwhelming.

Following the partial lifting of restrictions on free movement on April 23, 2003 some interlinkages were created with the economy of the government controlled-areas and with the outer world. This drastic change together with the exploitation of Greek-Cypriot properties and continued strong public consumption was the cause for the biggest boom

²³ This is a major issue which preoccupies the EU. For example, see Eurostat Statistical Books, Europe in figures – Eurostat year book 2006-2007, (European Commission, Brussels 2007); See also United Nations, Department of Economic and Social Affairs, Population Division, World Population Ageing: 1950-2050, (United Nations, New York). It is essential to note that various reports on the economy of Cyprus by the European Commission point out this issue.

²⁴ See Republic of Cyprus, Statistical Service, Demographic Report 2005, (Republic of Cyprus, Statistical Service, Nicosia 2006). See also Intercollege Business Consultancy Unit, Study for the "Formulation of Demographic Policy Proposal for Cyprus", (Intercollege Business Consultancy Unit, Nicosia 2002).

²⁵ See A. Theophanous, "Is Bizonal Bicommunal Federation Compatible with the Multicultural Society?" (in Greek), *Politis* newspaper, 2/12/2007, p. 12.

²⁶ A. Theophanous and Y. Tirkides, "Summary, Conclusions and Recommendations", in A. Theophanous and Y. Tirkides (Eds), *Accession to the Eurozone and the Reunification of the Cyprus Economy*, op. cit. It should also be noted that this issue was also addressed during a seminar organized by The Ministry of Finance of the Republic of Cyprus, entitled *Challenges inside the euro area: Life after 1/1/2008*, on Friday, November 9, 2007.

that has ever been experienced in the “TRNC”.²⁷ In the meantime discussions in relation to the Cyprus problem continued to be in a deadlock with the positions of the two sides remaining fundamentally entrenched. While both sides profess to desire a bizonal, bicommunal federation (however that may be defined) the Turkish-Cypriot side aspires to a system which is nearer to a confederation rather than a federation while Greek Cypriots would like a more integrationalist model.

It may be interesting to recall that for years the differences between the two sides with respect to solving the Cyprus problem extended to monetary issues as well. The questions raised included not only the issue of the national currency (the Cypriot pound or a new currency) but also the role and the structure of the Central Bank. The adoption of the euro and the inclusion of Cyprus in the Eurozone have changed the overall environment drastically. Not only is the issue of the national currency resolved once and for all, but the position and the role of the Central Bank also become clear. Monetary policy will be decided in Frankfurt and the role of the Central Bank of Cyprus will, by definition, be limited. Consequently, many of the pending issues in this domain are addressed conclusively within a broader perspective after the adoption of the single currency.

It should not escape our attention that participation in the EMU and the adoption of the euro as the national currency entail, among other things, notable implications in relation to the legal framework of the financial system as a whole. This in itself may be indicative of an overall philosophy encouraging financial integration.

At the same time participation in the EMU also entails serious obligations in relation to fiscal policy. At minimum this has to do with a philosophy of fiscal restraint; the budget deficit should be no more than 3% and the public debt no more than 60% of GDP.²⁸ Obviously these national obligations and/or constraints in relation to economic policy imply that there must be some form of coordination of policies the outcome of which cannot be left to a voluntary process of decision making. At the same time it becomes clearer that issues have more of a national dimension and less of a communal character.

All in all the changes embedded in the adoption of the euro and the participation of Cyprus in the EMU have far-reaching implications which perhaps have not been fully assessed and appreciated. The major influence will be toward a more integrationalist approach. It will be imperative to enhance cooperation and coordination and to adopt a national economic policy as a superior/supreme goal. This position may be better appreciated

²⁷ For interesting reading see M. Watson, “Growing Together? – Prospects for Economic Convergence and Reunification in Cyprus”, op. cit.

²⁸ During the conference organized by the Ministry of Finance of the Republic of Cyprus, *Challenges inside the euro area: Life after 1/1/2008*, (already noted previously), Charles Wyplosz, said that even in the case of a solution Cyprus may be given only limited time to have deficits higher than 3%.

if we also address this issue within the broader framework of Cyprus as a country the economy of which is integrated with the rest of the EU and the globalized world.²⁹

Perceptions and Misperceptions

It is essential to understand that the two communities have their own perceptions and misperceptions about themselves, their history and 'the other side'.³⁰ It is also important to understand that whether or not they are valid, these perceptions matter. Consequently, we must evaluate them to see if we can formulate a policy to address these misperceptions; alternatively and perhaps preferably there should be a comprehensive strategy to promote better understanding between the two communities.

A key area that is not fully understood by either community is the concept of federalism.³¹ As we have earlier noted, Greek Cypriots ideally prefer a more integrationalist settlement. This may well imply a federal structure with minimal territorial divisions. Thus, the area under Turkish-Cypriot administration would become a region and/or province rather than a constituent state within the framework of a final settlement.

Turkish Cypriots interpret this as the Greek-Cypriot desire for a unitary state in which Turkish Cypriots would have minority rights. Greek Cypriots feel this is an exaggeration; they see it as a reasonable arrangement within the framework of a strong type of federation. Yet this type of federation is different from what Turkish Cypriots see as their ideal arrangement.

If we consider the respective perspectives on federal structures, it is no surprise to find that Greek Cypriots focus on individual rights while Turkish Cypriots focus on collective rights.³² Cyprus is not unique in this debate over individual versus collective rights. However,

²⁹ It should also be noted that in the case of Cyprus there are additional important implications as noted in 2006:

"The accession of Cyprus to the Eurozone also entails major benefits in relation to the other major objective – that of reunification. Participation in the Eurozone greatly influences national economic policy as well as the decision-making processes. With accession to the Eurozone a much more integrated economic structure is created in relation to whatever was discussed previously as part of the solution of the Cyprus problem. Moreover, the risk of currency devaluation because of an increase in public spending and other developments due to a federal solution of the Cyprus problem, ceases to exist. In addition, with accession to the Eurozone the issue of a possible speculative attack against the Cyprus pound will cease to exist. Likewise the risk of exchange rate destabilization due to negative political developments again is also conclusively dealt with. ...Accession to the Eurozone, [especially at the existing exchange rate between the Cyprus pound and the euro] will secure incomes but moreover it will boost the morale and further enhance the dynamism and the confidence of the Cypriot economy. These characteristics are essential for the convergence of the standard of living between Greek Cypriots and Turkish Cypriots and eventual reunification."

See A. Theophanous and Y. Tirkides, "Summary, Conclusions and Recommendations", in A. Theophanous and Y. Tirkides (Eds), *Accession to the Eurozone and the Reunification of the Cyprus Economy*, op. cit., especially p. 244.

³⁰ For interesting reading see Y. Papadakis, *Echoes from the Dead Zone – Across the Cyprus Divide*, (I.B. Tauris, London 2005).

³¹ Perhaps this statement should be qualified given that perhaps this has also been the outcome of the fact that there may be different variations of federalism. For interesting reading, see research project entitled "Coordination and Formulation of EU Policy in a Federal Cyprus", by Ch. Ioannou, Nicosia 2006.

³² For interesting reading see E. Neisser, "A Federalism Process for Cyprus: An American Constitutional Perspective on the Cyprus Problem", *The Cyprus Review*, vol. 8, no. 2, Fall 1996, pp. 7-23; E. Neisser, "Individual and Communal Rights in the Constitutional Framework of a Federal Cyprus: Lessons from the American Experience" in A. Theophanous, N. Peristianis, A. Ioannou (Eds), *The Cyprus Problem: Its Solution and the Day After* (Intercollege Press, Nicosia 1998) pp. 87-98.

because there is need for an overall agreement on the form of a federal structure, both perspectives must be studied carefully. From a political perspective it may be pragmatic to adopt a philosophy that gives equal weight to individual and collective rights.

It is also no surprise that the two sides have different approaches in relation to history, its interpretation and to what is of primary importance. In one way or another, this again may have an impact on political processes as well as the final constitutional arrangements. Greek Cypriots focus basically on the crisis and the events of 1974. For Greek-Cypriot public opinion this is the year that brings a cataclysmic change to the politics of Cyprus.³³

In contrast, Turkish Cypriots view the events of 1963 as the defining moment and the events of 1974 as an inevitable outcome of a process that had started before.³⁴ In essence, from the Turkish-Cypriot mainstream perspective, 1963-1974 was an extremely difficult period in all aspects. The events of 1974 allowed Turkey to “intervene” and to create a new state of affairs – a state of affairs that satisfied Turkish Cypriots.

Retrospectively, Greek Cypriots understand that the period 1963-1974 cannot be dismissed without due consideration of events and their consequences. And many Turkish Cypriots understand that 1974 had additional dimensions which go beyond their own perceptions.

The implications are clear. It is of utmost importance for the two sides to adopt a comprehensive perspective on events without necessarily having to agree. The first fundamental step is to be aware of the different perspectives and sensitivities. This perhaps may contribute to a new approach when outlining the different aspects of the Cyprus problem but above all it has important ramifications for the way forward.

It should also be noted that events associated with the submission of the Annan Plan, the partial lifting of restrictions on the free movement of people on both sides of the green line, the referenda of April 24, 2004 and the subsequent events have also greatly affected the broader environment at the psychological level. Turkish Cypriots feel that they not only had supported the Annan Plan but had also outvoted their historical leader Rauf Denktaş, so as to facilitate the solution of the Cyprus problem. They saw the Greek-Cypriot resounding NO in the referendum as a rejection of the prospect for a solution and co-existence within a federal arrangement.

To Greek Cypriots, however, their NO was inevitable since their perception was that Annan Plan V worsened the *status quo* for them. Greek Cypriots point out that they could

³³ For excellent reading see N. Peristianis and G. Tsangaras, (Eds), *Anatomy of a Metamorphosis* (in Greek), (Intercollege Press, Nicosia 1995).

³⁴ In essence, for the Turkish Cypriots 1963 is the beginning of the Cyprus problem. For interesting reading, see Y. Papadakis, “20 Years after What? The Multidimensional Meaningfulness of 1974”, in N. Peristianis and G. Tsangaras, (Eds), *Anatomy of a Metamorphosis* (in Greek), op. cit., pp. 353-369, and especially pp. 358-360; M. Attalides, “The Turkish Cypriots: Their Relations to the Greek Cypriots in Perspective” in M. Attalides (Ed.), *Cyprus Reviewed*, op. cit., pp. 71-97. See also P. Oberling, *The Road to Bellapais*, op. cit.; Z. Negatigil, “The Cyprus Conflict in International Law” in C. H. Dodd, *The Political and Social Development of Northern Cyprus*, op. cit.

be generous to Turkish Cypriots but they could not accept the protectorization of Cyprus by Turkey via, for example, the continuation of Turkish guarantee rights.

Turkish Cypriots also feel that Greek Cypriots maintain a “policy of embargoes” and that in reality they feel reluctant to pay the costs of reunification and share wealth and the benefits of EU membership with them. On their part Greek Cypriots feel that Turkish Cypriots are very well aware of their rights and invoke the Republic of Cyprus when it is to their interest. But, according to the mainstream Greek-Cypriot view, they shy away from their obligations. And what is even worse, it is questionable where their allegiance lies.

Greek Cypriots also point out the economic openings toward Turkish Cypriots, including the fact that many now work on a full- or part-time basis in the government-controlled areas.³⁵ They also refer to measures implemented by the government of Cyprus, such as free medical care, which may indicate a preferential treatment of Turkish Cypriots. For the Greek Cypriots there is no embargo – to the extent Turkish Cypriots feel isolated, this is the outcome of the Turkish occupation of the northern part of Cyprus, they argue.

There is also bitterness among Greek Cypriots in relation to the excessive usurpation of Greek-Cypriot property in the occupied northern part of Cyprus. All in all, what is unfortunate is that the post-2003 environment, which has allowed many more contacts and networks between the two sides, has also been associated with a feeling of mistrust and bitterness.³⁶ Yet, for Greek Cypriots there is a feeling that things could change again if there is a fundamental change in Turkish policy over Cyprus.³⁷

Possible Outcomes: The Four Scenarios

Within the framework of the different positions of the two sides, the perceptions and the misperceptions, as well as the particular realities arising from economic factors and considerations, we will propose several possible outcomes. As already stated there are four scenarios that will be addressed:

- (a) The first scenario revolves around a bizonal bicomunal federation. We will outline the major characteristics of this model, considering all relevant factors: the positions of the 1977 and 1979 high level agreements, the relevant resolutions of the UN Security Council, the ideas submitted by the UN over time including the Ghali Set of Ideas and the Annan Plan.
- (b) The second scenario examines the continuation of the stalemate/*status quo*. In this regard we will take into consideration all relevant factors and characteristics. We will

³⁵ E. K. Markoullis, “The Alleged ‘Isolation’ of Turkish Cypriots: Myth and Reality” Interactive CD in five languages developed by the Press and Information Office, Republic of Cyprus, (2006).

³⁶ It may be supported that if the broader political environment had been different, the outcomes of the post-2003 period could have been different too.

³⁷ This feeling has been strengthened following the election of Demetris Christofias as President of the Republic of Cyprus on February 24, 2008.

also attempt to incorporate a dynamic analysis in relation to this scenario as it eventually influences the outcome of issues under examination. For example, to the extent that the international community considers the *status quo* a situation that is mostly associated with the isolation of Turkish Cypriots this may play a role in more openings. In contrast, to the extent that the *status quo* and the problems of the Turkish Cypriots are seen as an outcome of the Turkish occupation of the northern part of Cyprus, this may result in different policy perspectives.

- (c) The third scenario focuses on a two-state solution. This may be the outcome of a negotiated agreement in which the Republic of Cyprus recognizes the “TRNC” as an independent country in return for territorial rearrangements. This may be considered as the “land for recognition formula”. Within this framework the property issue is also addressed.
- (d) The fourth scenario focuses on what the author terms “functional federation with loose bizonality”. It should be noted from the start that the characteristics of this model derive from an integrationalist federal approach.

The Political Economy of the Four Scenaria: An Overall Assessment

A fundamental theoretical assumption adopted in this study is that each form of a solution entails a particular set of economic characteristics. Inevitably this is intertwined with a given economic structure. This in its turn affects the economic outcomes and overall record.

As already outlined, this study examines four specific scenaria: bizonal bicomunal federation, the continuation of the stalemate/*status quo*, a two-state solution and functional federation with loose bizonality. For each scenario we analyze the economic dynamics in relation to specific issues. These revolve around the following: the property issue, property compensation, the three fundamental freedoms, fiscal policy, the legal framework, the financial system, the economics of development, the Social Security Fund and related policies, competition, local administration, settlers, immigration, foreign workers, tourism, environment, education, health and consumer protection.

The objective will be to determine whether, at least from the economic perspective, any particular scenario constitutes a distinctively exceptional outcome. Within the framework of the same philosophy and methodology there will be a comparison of the four models. Last but not least, we will attempt to assess whether, from the economic perspective, there are specific scenaria which are seen more favourably by each of the two communities.

The outcome of this discussion may help us understand better the positions taken by the two sides. Moreover, the hope is that this analysis can offer evidence that particular policy options can lead to mutual gains for the two communities.

III. SCENARIO A: BIZONAL BICOMMUNAL FEDERATION

The Philosophical Positions and the Structure of a Bizonal Bicommunal Federation

Despite the fact that there is no common understanding between the two sides on the definition of a bizonal bicommunal federation, much work has been done at the negotiations table since the seventies under the auspices of the UN. For the purposes of this research work we will utilize the positions of the two sides (especially during the negotiations) as well as the several documents, suggestions, ideas and plans the UN has submitted over time.¹ We note, however, that there are alternative ways that this arrangement can be structured. Indeed, the model examined in Chapter VI, functional federation with loose bizonality, may in fact be a special case of a bizonal bicommunal federation.

Structure of the State

A bizonal bicommunal federation envisages the existence of two component/constituent² states that will be linked together under a common umbrella by a (third) federal state structure. Inevitably this arrangement will include characteristics of both a federation and a confederation. The future unity of the state may not be fully certain although within the framework of such a solution there will be a statement reaffirming the “single personality” of the state.

Sovereignty

In international law only states have sovereignty, not their component/constituent parts. Given that in the case of Cyprus this has been one of the most difficult issues in the post-

¹ The Ghali Set of Ideas (S/24472 August 21, 1992) and the Annan Plan (2002, I, II, 2003, III, 2004, V) may be indicative of the perspectives of the international community in relation to the discussed framework of a bizonal bicommunal federation. Within this perspective it is expected by supporters of this philosophy that with particular changes and/or additions it may be possible to arrive at an agreed framework. <<http://www.un.int/cyprus/scr774.htm>> <<http://www.un.org/Depts/dpa/annanplan/annanplan.pdf>>

² The first two versions of the Annan Plan (Annan I, II) referred to component states. In Annan III and V the term component changed to constituent. This change signified symbolic as well as constitutional changes. The term “constituent state(s)” would confirm that the new state was indeed created by two constituent states which recognize each other as equal. Indeed, the change was a gradual shift from the model of federal state toward a form of confederation. For an interesting theoretical discussion see D. J. Elazar, *Exploring Federalism* (The University of Alabama Press, Tuscaloosa and London 1987); D. J. Elazar, Introduction in I. D. Duchacek, (Ed), *Bicommunal Societies and Politics (Publius: The Journal of Federalism)*, vol. 18, no. 2, Spring 1988 pp. 1-3. For an interesting summary of various views on these issues see also A. Theophanous, *European Cyprus: Constitutional Structure Economy and Society. Accession and Solution Scenaria* (in Greek), op. cit., especially pp. 113-157.

1974 period, the solution may in practice entail three sovereignties: one of the central government and one for each of the two component/constituent states. The political, legal and constitutional justification for such a position may invoke, *sui generis*, the concept of internal and external sovereignty.³

This may create many grey areas. In effect there will be no safety valves for dealing with problems arising from different interpretations. Most likely, at times of disagreement, there will be deadlocks or the *de facto* imposition of the will of the stronger party, in other words, of the Turkish side. In the best possible case deadlocks may end up in the Supreme Court. If the composition of the Court is similar to the one proposed in the Annan Plan or as envisaged by the Zurich-London agreements, then the foreign judges will effectively have much political power.⁴

Competences of the Central Government and of the Component/Constituent States⁵

There will be competences and functions that will be exclusively allocated to the central government and competences and functions that will be exclusively allocated to the two component/constituent states. Inevitably there will be competences and functions that will be exercised concurrently by both levels of government.

There will be no hierarchy between the laws of the central government and those of the component/constituent states.⁶ Obviously, if there are different perspectives or even disagreements on particular issues, most likely the Supreme Court will decide on the issue. Furthermore, whatever competences are not explicitly allocated to the central government will belong to the two component/constituent states. In essence, the central government's exercise of its powers and responsibilities presupposes double majorities.

Participation in the Central Government, in the EU and in International Fora

There will be effective participation of Turkish Cypriots in the central government and at all levels. In some aspects effective participation will entail equal participation such as in the Senate and the Supreme Court. There will be a Presidential Council or the Zurich-London Presidential System, while the decision-making process will require double majorities.⁷

³ For an interesting discussion of some key issues which are raised see D.J. Elazar, *Exploring Federalism*, op. cit.

⁴ It should be remembered that under the Annan Plan there were to be three judges from each constituent state as well as three foreign judges. In the London-Zurich constitution the Supreme Court consisted of one Greek-Cypriot judge, one Turkish-Cypriot judge and one foreign judge.

⁵ For an interesting theoretical discussion on these issues in addition to D. J. Elazar, *Exploring Federalism*, op. cit., see A.E. Pandelides, *Federal Constitutions and the Division of Powers and Competences between the Federation and the States*, (Intercollege Press, Nicosia 2001).

⁶ Again note that this was one of the provisions of the Annan Plan.

⁷ It should be recalled that in the London-Zurich constitution the President was elected by the Greek Cypriots and the Vice-President by the Turkish Cypriots. Both the President and the Vice-President had the right of absolute veto. In the Annan Plan there was a Presidential Council with rotating Presidency; for decisions to be reached in essence dual majorities were required. It may be interesting to recall the period 1960-1963 and how these issues affected the functionality of the government. See S. Kyriakides, *Cyprus: Constitutionalism and Crisis Government*, op. cit.

In essence, bizonality, bicommunality and political equality will inevitably be reflected in Cyprus's participation in the EU and all international fora. This means that Greek Cypriots and Turkish Cypriots will have to come up with a single voice/opinion in European and international fora. Furthermore, Turkish Cypriots must have effective participation in the Cyprus missions in the EU and internationally.

Understandably, this arrangement implies that both Greek and Turkish Cypriots serving the Federal Republic of Cyprus or the United Cyprus Republic will work in ways that serve its overall interests. The question that arises is whether or not this would indeed occur. In this regard Greek Cypriots feel that the allegiance of Turkish Cypriots may be elsewhere and not to a unified common homeland.

The Three Fundamental Freedoms

Under a strict bizonal bicomunal system the three fundamental freedoms (freedom of movement, of settlement, and of acquisition of property) will be implemented to the extent that they do not affect bizonality, thus serving collective rights over individual rights. This means that there will be long-term or even permanent derogations from the implementation of the two fundamental freedoms (freedom of settlement and of acquisition of property). Taking into account all relevant factors and the provisions of the plan, there will always be limitations on the freedom of settlement and of acquisition of property.⁸

Territorial Arrangements, the Property Issue and Human Rights

The Greek-Cypriot component/constituent state will have under its administration 70,8% of the territory of the United Cyprus Republic and the Turkish-Cypriot component/constituent state 29,2%. The transfer of territory will take place within the framework of a reasonable time period.⁹

In relation to the property issue, there will be full restitution of properties to Greek Cypriots in the territories that will come under Greek-Cypriot administration. All other cases will consider the realities on the ground and will be based on exchange of properties and compensation. Toward this end the role of the market will also come into play. In other words, even if the principle of restitution is fundamentally recognized, in effect there will be exchanges and compensation.¹⁰

⁸ This has always been a major position of the Turkish side. For a (short) summary of the positions of the two sides and the implications see A. Gürel and K. Özersay, *The Politics of Property in Cyprus: Conflicting Appeals to "Bizonality" and "Human Rights" by the Two Cypriot Communities*, PRIO Cyprus Center, Report 3/2006, International Peace Research Institute, op. cit., especially pp. vii, viii, ix.

⁹ Proposals put forward by the UN (during the last effort 1999-2004 which culminated in the Annan Plan) in relation to territorial arrangements revolved around 70,8% for the Greek-Cypriot and 29,2% for the Turkish-Cypriot component/constituent state. The Ghali Set of Ideas suggested that 28,5% of the land should be under Turkish-Cypriot administration. It is also worth noting that when Gobbi put forward suggestions for a confederation in his own personal capacity, and not as a UN representative, he had suggested that around 75% of the territory should be under Greek-Cypriot administration. It is obvious that as time passes it will become more difficult for the two sides to agree on the territorial issue. H. J. Gobbi, *Rethinking Cyprus*, (Editorial Aurora, Tel. Aviv 1993), p. 49. Gobbi rhetorically raises the question: "Also, I would ask the Greek Cypriots who do not live as prisoners of the past, what is better: to own 100% of around three quarters of the Island, or to possess 50% of the whole. Because that is the only present alternative despite optimistic hopes."

¹⁰ If an arrangement takes place within the framework of imposition the economic and other outcomes are different in comparison to the situation when an agreement/arrangement is voluntary.

In this scenario, individual human rights will inevitably be compromised. One question is whether such compromises will be accepted and/or legitimized. For this particular scenario, bizonality, bicommunality and political equality are of first importance; human rights will only be respected to the extent that these critical guidelines are not reversed or even negatively affected.

Settlers and Immigration Policy¹¹

The settlers who will eventually stay will be given residency status, while their children will be granted full citizenship with all attendant rights and privileges. Given that this is a highly sensitive issue, immigration policy should rest exclusively with the central government. Given that the further inflow of Turks from Anatolia may create additional demographic pressures on the Greek Cypriots, it is understood that there will be a permanent derogation. It is questionable, however, whether the central government will be in a position to control such inflows even if there is an agreement.

Economy

Although in theory the accepted goal is an integrated economy, in practice the constitutional clauses in relation to bizonality and bicommunality will, by introducing derogations from the basic freedoms, have a negative impact on this goal. The essentially segregated constitutional structure will affect all aspects of economic life, from the decision-making process to social policy.¹² It must be questioned whether and how the process of economic integration will work. It should also be stressed that the convergence of living standards of the two component/constituent states is of utmost importance for social cohesion and political stability.¹³ Strong bizonality and bicommunality do not encourage integration; thus, the goal of achieving convergence will be decelerated, with potentially destabilizing political implications.¹⁴

¹¹ For interesting reading see Council of Europe, Parliamentary Assembly, Committee on Migration, Refugees and Demography, "Colonization by Turkish settlers of the occupied part of Cyprus, Memorandum, Rapporteur: Jaako Laakso, AS/mg, 20 September 2002; M. Hatay, Beyond Numbers: Inquiring into the Political Integration of "Turkish Settlers" in Northern Cyprus, op. cit. It should also be noted that according to estimates of the government of the Republic of Cyprus the number of settlers was around 180,000 by the end of 2007. On the other hand, according to Turkish-Cypriot sources (including the 2006 census) the number of settlers may be estimated at around 120,000. In this regard see also M. Hatay, "Is the Turkish-Cypriot Population Shrinking?", op. cit.

¹² For interesting reading see A. Drazen, *Political Economy in Macroeconomics*, op. cit., especially 675-733.

¹³ While divergence of income levels in different regions of the same country is common, in the case of a reunified country it is important that both sides are seen to gain from reunification.

¹⁴ In such an unfortunate scenario we could enter a vicious circle: bad political framework leading to poor economic outcomes and reinforcing a poor political environment.

The Political Economy of a Bizonal Bicomunal Federation

As already noted the constitutional arrangements of a particular plan have their own impact on the economic structure. In its turn economic structure has its own impact on the economic record. In this section we examine the likely economic effects of this particular model.

Property Issue

Evidently the impact on the property issue depends on both the territorial arrangements and the constitutional arrangements in relation to bizonality. Assuming that the Greek-Cypriot component/constituent state will have 70,2% of the territory of the United Cyprus Republic, effectively about 7,5% of territory will be returned. This means that immediately there will be restitution of properties for a section of the displaced persons. If we take Annan V as a point of reference, the corresponding territorial arrangements mean that almost 50% of the displaced Greek Cypriots (or all the legal owners) will receive their properties back under Greek-Cypriot administration.¹⁵

For the remaining Greek-Cypriot properties that will be under Turkish-Cypriot administration, the following arrangements will apply: some of the properties will be returned to their owners, some will be exchanged and the remaining will be compensated based on market value or adjusted market value. The best outcome in relation to the land that will not be returned is to recognize restitution in principle, but at the same time encourage economic agents to proceed with buying and selling through the market mechanism. If the market is utilized accordingly then we may have very beneficial results.

In relation to Turkish-Cypriot properties that will be in the Greek-Cypriot component/constituent state similar provisions will apply. Turkish Cypriots will greatly benefit given the high prices in the government-controlled areas.

Overall, developments from the property arrangements will impact favourably on the economy. While, inevitably, there will be people who will not be satisfied, the overall effect will be positive. It should be stressed that the biggest impact will be associated with a very strong wealth effect. In addition there will be a *de facto* increase in the supply of land via a legitimization process that will have an additional positive impact on the economy.¹⁶

Compensation

To the extent that some arrangements may require extensive compensation outside the market place, this may create problems. It will be impossible to cover all necessary compensation

¹⁵ This is an assessment based on relevant papers and documents that have been published so far. These include A. Gürel and K. Özersay, *The Politics of Property in Cyprus: Conflicting Appeals to "Bizonality" and "Human Rights" by the Two Cypriot Communities*, PRIO Cyprus Centre, Report 3/2006, International Peace Research Institute, op. cit., see especially p. 29.

¹⁶ For interesting reading see S. Platis, S. Orphanides and F. Mullen, *The Property Regime in a Cyprus Settlement: A Reassessment of the Solution Proposed under the Annan Plan, Given the Performance of the Property Markets in Cyprus, 2003-2006*, PRIO Cyprus Centre, Nicosia, Report 2/2006; F. Mullen (Ed.), *Economic Perspectives in Cyprus: the Path Towards Reunification*, (Proceedings, 22 November 2006, PRIO Cyprus Centre, Nicosia, 2007).

from funds from external sources (i.e. donors). Consequently, if for compensation purposes taxpayers are called to pay a price, either directly or indirectly, there will be a negative impact on the economy.¹⁷ On the other hand, if the formula put forward in this research study is adopted – that is, recognition of the principle of restitution and reliance on the market – the problems will be reduced. On the other hand, a plan that adopts strict bizonality means less reliance on market forces and greater reliance on compensation, resulting in greater problems for the economy.¹⁸

The Three Fundamental Freedoms

The three fundamental freedoms have different dimensions: political, economic, social and cultural. Greek Cypriots have considered this to involve inalienable human rights.¹⁹ Be that as it may, for the purposes of this study we focus on the economic dimensions. The right of settlement and of acquisition of property is inevitably influenced by the bizonality clauses. The stricter the bizonality clauses the greater the limitation of these two specific fundamental freedoms. In turn, the greater the limitation of these fundamental freedoms, the greater the impediments toward achieving economic integration. If the two component/constituent states end up to be predominantly and ethnically almost homogeneous, in essence we will have two separate structures. This will not lead to social and economic integration.

Furthermore, it is also possible for Turkish-Cypriot social networks to be created in the Greek-Cypriot component/constituent state but the reverse is unlikely to take place. This is because of several factors, the two most important of which are: people usually move to areas that are richer and offer better prospects; for several reasons, Greek Cypriots will be less inclined than Turkish Cypriots to live under the administration of the other side. In this respect we should recall that many settlers will eventually stay in the Turkish-Cypriot component/constituent state.²⁰

Fiscal Policy

Inevitably, within the framework of a bicomunal bizonal structure involving the component/constituent states and a central government there will be three fiscal policies. This may not be efficient for a country of the size of Cyprus.²¹ In addition it should be noted

¹⁷ This is particularly important for Cyprus, since its low corporate tax rate has created a dynamic business services sector that has compensated in many ways for declining tourism.

¹⁸ See A. Theophanous, *The Cyprus Question: The Challenge and the Promise*, op. cit., pp. 89-90; A. Theophanous, *The Annan Plan and the European Option* (in Greek), op. cit., especially pp. 121-135.

¹⁹ A. Gürel and K. Özersay, *The Politics of Property in Cyprus: Conflicting Appeals to "Bizonality" and "Human Rights" by the Two Cypriot Communities*, PRIO Cyprus Centre, Report 3/2006, International Peace Research Institute, op. cit., especially pp. vii, viii, ix, 1, 2.

²⁰ A. Theophanous, *The Annan Plan and the European Option* (in Greek), op. cit., pp. 82-83 and M. Hatay, *Beyond Numbers: Inquiring into the Political Integration of "Turkish Settlers" in Northern Cyprus*, op. cit.

²¹ For interesting reading see A. Drazen, *Political Economy in Macroeconomics*, op. cit., pp. 675-733.

that given Cyprus's participation in the EU and moreover in the EMU, there are certain obligations that should be met. For example, the budget deficit and the public debt should not exceed 3% and 60% of the GDP respectively. For this to be achieved there must be a minimum level of coordination and cooperation between the three governments on the island. It remains to be seen whether this will be possible.

Under a model that emphasizes segregation rather than integration it may be difficult to achieve the desired level of coordination. Furthermore, given the different levels of development in each component state the goals and priorities will not be the same. This may create strains. If, for example, the Turkish-Cypriot component/constituent state cannot achieve its target and has a higher deficit, there will be pressure on Greek Cypriots for tighter fiscal policy. This is likely to create tensions as it will essentially entail additional Greek-Cypriot indirect subsidies to the Turkish-Cypriot component/constituent state. We want to emphasize that it is not the subsidies *per se* which may cause problems, but rather how or why they arise.²²

Legal Framework

Cyprus as a member of the EU had to adopt a particular legal framework dealing with all aspects of public life: from business law, to public health and to consumer issues. Inevitably this would substantially contribute towards the legal harmonization on both sides in Cyprus. Particular attention should be given to the issue of the legal framework of the overall/broader financial system. Given Cyprus's participation in the EMU the harmonization process for the Turkish-Cypriot component state will be very demanding. If implemented quickly this would be a significant factor toward the integration of Cyprus's economy.²³ One of the issues raised is whether or not the existence of two component/constituent states will act as a deterrent to the prospect of a uniform legal framework throughout Cyprus.²⁴

Decision-Making Process

The decision-making process in any state is of fundamental importance. It may facilitate, slow down or impede processes. Policy paralysis is an undesirable outcome as it is associated with very negative repercussions. There is a high risk that the bizonal bicomunal model that we have described would result in such problems. It is interesting to assess the

²² It is one thing to agree on a particular economic policy which will entail flows of resources from the Greek-Cypriot to the Turkish-Cypriot component/constituent state; it is another if, additionally, the fiscal situation of the Turkish-Cypriot component/constituent state necessitates additional sacrifices by the Greek-Cypriot component/constituent state.

²³ For interesting reading in relation to the implications of financial harmonization see Y. Tirkides, "The Challenges of Accession to the Eurozone and the Reunification of the Cyprus Economy", "Conditions and Prerequisites for the Accession of the Cyprus Economy to the Eurozone and its Reunification", in A. Theophanous and Y. Tirkides (Eds), *Accession to the Eurozone and the Reunification of the Cyprus Economy*, op. cit., pp. 83-107 and 181-214 respectively. For an interesting theoretical perspective see also P. De Grauwe, *Economics of Monetary Union*, (4th edition), (Oxford University Press, Oxford 2000).

²⁴ For example, would we have the creation of strong Cypriot financial entities or would the emphasis be on the Greek-Cypriot or Turkish-Cypriot bank, insurance company, and/or another financial institution?

situation in Belgium, a country whose complex constitutional mechanisms are essentially defined by two linguistically distinct regions. We note especially that the crisis that started in June 2007 after the elections was long and had negative repercussions; in this particular case a government could not be formed for nine months.²⁵ This example of policy paralysis took place in Belgium, a western European country whose capital city is also the capital of the EU. In Cyprus, things are likely to be even more difficult, considering both the country's turbulent history context and the direct involvement of outside powers.

The Economics of Development

A major economic objective of the 'United Cyprus Republic' on the day after the solution would be the economic convergence of the two component/constituent states. Inevitably there will be the temptation to focus only on achieving harmonization of standards of living or incomes per capita in nominal terms. Although in principle this is a legitimate objective it is essential to also address the issue of convergence of other economic variables as well. This includes productivity, size of the public sector and so on. Indeed convergence of standards of living can only take place on a sustainable basis if the major economic indicators and parameters move simultaneously.²⁶

The overall objective of economic convergence will also be affected by policy coordination at the three levels of government. It would be both unreasonable and erroneous to try to achieve real economic convergence exclusively through grants from the Greek-Cypriot component/constituent state and from the EU. On the contrary, the key to real economic convergence is economic integration. Thus, the role of the market will be important. On the other hand, though, to the extent that bizonality remains entrenched, it will not be an exaggeration to expect that convergence and integration will never be fully achieved.

Another issue of primary importance is the role of the central government in promoting economic convergence. If the central government's power is limited due to constitutional arrangements, and most power lies with the two governments of the two component/constituent states then the overall effort will inevitably face additional difficulties. If

²⁵ For a general/overview comparison between Cyprus and Belgium see K. Deschouwer, *The Belgian Model and the Case of Cyprus*, speech at a conference organized by the then Research and Development Center – Intercollege (now the Cyprus Center for European and International Affairs – University of Nicosia), entitled "The Cyprus Problem and Cyprus' Accession to the European Union", 4-6 April 2002. In relation to the recent crisis in Belgium it is useful to recall the frequent government deadlocks in Belgium; in other words it was not an unusual phenomenon. It is important to note that elections took place in Belgium in June 2007 and a government was formed in March 2008. For interesting reading see "Belgium in Deep Political Crisis as Government Talks Collapse", *International Herald Tribune*, Wednesday, November 7, 2007; B. Hans, "Is Belgium Falling Apart?", *Spiegel* online, August 11, 2007; G. Rodriguez, "Belgium's Identity Crisis", New America Foundation, September 17, 2007; R. Cohen, "What Crisis in Belgium?", *International Herald Tribune*, Sunday, December 16, 2007; T. Helm, "Government Crisis in Belgium over Dutroux's Escape", *News Telegraph*, April 25, 1998; P. Belien, "Coup d'Etat in Belgium? King Bestows Extended Powers on Outgoing PM", *Canada Free Press*, Monday, December 3, 2007.

²⁶ It is interesting to note the experiences of German reunification. Indeed, one of the lessons is that it is of utmost importance that the convergence process must include productivity levels. See H. Brey, "The German Experience of Reunification and Useful Lessons for Cyprus" in A. Theophanous and Y. Tirkides (Eds), *Accession to the Eurozone and the Reunification of the Cyprus Economy*, op. cit., pp. 143-179.

socioeconomic convergence between the two regions is not somehow achieved, this will be a source of frictions and misperceptions. It will also influence labour flows, quality of services offered and so on.²⁷

Social Security Fund and Related Policies

In federal states, more often than not, there is one Social Security Fund. In the case of a bizonal bicomunal solution, each component/constituent state will have its own social policy and the role of the central government will be limited.²⁸ Within the framework of this particular arrangement each state will have its own Social Security Fund. Furthermore, each component/constituent state will have its own related social policies dealing with such issues as unemployment, early retirement due to health and other reasons and so on. Inevitably this arrangement may lead to different and less desirable outcomes.²⁹ This in its turn will not contribute to socioeconomic convergence of the two regions in Cyprus. From this we can deduce that there is an inverse relationship between strict bizonality and socioeconomic integration and convergence.

There are also practical issues to consider including complications with workers who over time will have worked in both component/constituent states. If, for example, a Turkish-Cypriot who works in the Greek-Cypriot component/constituent state loses his job, which state will pay unemployment compensation benefits? The reasonable option is to have one fund and plan for the whole country. But it is unlikely that this will take place within the framework of this model.

Competition

Competition as a goal is influenced by a particular set of factors. These include primarily how market forces work as well as the legal framework. Obviously the fact that Cyprus is a member of the EU will contribute to a great extent toward the enhancement of competition.

Competition may be hindered by the provisions of bizonality, however.³⁰ The overall situation would greatly improve in relation to the *status quo* but will be suboptimal in relation to what would occur with a truly integrated economy without bizonality or at least with only loose bizonality.

²⁷ For some interesting theoretical perspectives see A. Drazen, *Political Economy in Macroeconomics*, op. cit., pp. 675-733, J. D. Donahue, "Tiebout? Or Not Tiebout? The Market Metaphor and America's Devolution Debate", *The Journal of Economic Perspectives*, vol. 11, no. 4, Fall 1997, pp. 73-82.

²⁸ It is essential to note that Annan Plan V does not address this issue comprehensively. Instead it makes a general assertion/declaration; that the two constituent states would "strive to coordinate or harmonize their policy and legislation" of, *inter alia*, social security and labour policy (Article 16 (3) (h)).

²⁹ It is worth noting in this regard that the World Bank Report on northern Cyprus describes the Social Insurance Fund as "bankrupt". See World Bank Report, "Sustainability and Sources of Economic Growth in the Northern Part of Cyprus", Volume I: Economic Assessment, p. 32, op. cit.

³⁰ Ideally the objective would be for Cyprus to focus on external competitiveness. With strict bizonality we may have a situation where competition is basically between the two component/constituent states.

Another element worth noting is that within the framework of a bizonal bicomunal federation each component/constituent state would probably have its own representatives handling foreign imported goods. This in itself may not be a negative development since exclusive representations are often associated with semi-monopoly situations.

Local Administration

Local administration is a very important aspect of government. In a bizonal bicomunal federation and with the focus on the governments of the two component/constituent states, local government may be adversely affected.

We wish to point out that, within a bizonal bicomunal federation, Cyprus in essence will have four levels of governance;

- Brussels/Frankfurt – The EU dimension
- The central government of the ‘United Cyprus Republic’
- The governments of the two component/constituent states
- Units of local administration

With the framework of such a constitutional arrangement units of local government may not receive their fair share of attention. It should be noted that within a different constitutional arrangement in which the role of regional governments is limited, local administration will have an enhanced role.³¹

Settlers

The issue of settlers is highly sensitive and involves security, political, economic, social, cultural, legal and humanitarian issues. Greek Cypriots view the growing number of settlers as a security issue, as it tends to dramatically change the demographic structure of the island.³²

From a more practical perspective, there is the question of how and to what extent the settlers influence the viability of a solution. It should be noted that if, as has been repeatedly reported, Turkish Cypriots have problems with the settlers, Greek Cypriots will be even less receptive to the idea of living together with them.

Taking everything into consideration, it appears that if many settlers remain after a solution, there are likely to be tensions. If this is a valid statement, then the guarantor

³¹ For interesting perspectives on these issues see J. D. Donahue, “Tiebout? Or Not Tiebout? The Market Metaphor and America’s Devolution Debate”, op. cit.; R. A. Musgrave, “Devolution, Grants, and Fiscal Competition”, *The Journal of Economic Perspectives*, vol. 1, no. 4, Fall 1997, pp. 65-72. For basic but interesting reading in relation to the role of regions in the EU see A. Bourne, “Regional Europe”, in M. Cini (Ed.), *European Union Politics*, (Oxford University Press, Oxford 2003), pp. 278-293.

³² See Greek-Cypriot Proposals 1989; See Council of Europe, Parliamentary Assembly, Committee on Migration, Refugees and Demography, “Colonization by Turkish settlers of the occupied part of Cyprus, Memorandum, Rapporteur: Jaako Laakso, AS/mg, op. cit.; For a Turkish-Cypriot view see M. Hatay, *Beyond Numbers: Inquiring into the Political Integration of “Turkish Settlers” in Northern Cyprus*, op. cit. In this regard see also speech of Retired General and former Minister of Defence of the Republic of Cyprus Ph. Klokkaris entitled *Threats to the Security of Cypriot Hellenism due to the Turkish Occupation*, on January 30, 2008 at the SEK trade union. See Simerini website: <<http://www.simerini.com.cy>>

powers under the 1960 agreements should find ways to address this issue constructively. Likewise the EU and the US could be helpful in various ways; for example, EU countries and also the US could agree to offer residency or citizenship to a number of settlers.

Immigration and Foreign Workers

In federal states issues of immigration, including work permits for foreigners to work in the country, are the responsibility of the central government. Consequently, in Cyprus, even if a bizonal bicomunal federation were established, this function/competence should belong to the central government.

The question that may come to the surface, however, is whether the component/constituent states would practically allow the central government to pursue its duties effectively. We also note that this competence entails obligations toward the EU, especially if Cyprus is to sign the Treaty of Schengen.

There are two issues that should be evaluated in this regard. First, workers from other countries of the EU will not need visas or permits to settle and to work in Cyprus. Second, Cyprus will be attractive for people from Turkey and the Middle East either as a final destination or a transit place before they end up in a bigger member state of the EU.³³

Tourism

Tourism constitutes one of the most important sectors of the economy of Cyprus. Following a solution to the Cyprus problem there will be several developments in relation to this sector as well as the economy in general. Indeed there will be both microeconomic as well as macroeconomic developments.

A solution to the Cyprus problem will provide legitimacy with multidimensional implications and repercussions. This will be undoubtedly associated with an expansion of the tourist inflow. The northern part of Cyprus will be utilized even more from a tourist perspective. With normalized relations with Turkey there will be even more opportunities for cooperation and joint projects. Although it is expected that the expansion of tourism and of the relevant infrastructure will be concentrated mostly in the northern part of Cyprus, the economy of the whole island will be positively affected.

We could also expect changes in the relative prices of the tourist product in Cyprus. In this regard we cannot underestimate the possibility for competition between tourist interests in the two component/constituent states. Thus, while on the one hand there will be cooperation

³³ This is already taking place. According to Ph. Klokkaris, *Threats to the Security of Cypriot Hellenism due to the Turkish Occupation*, op. cit., it is estimated that by the end of 2007 there were 180.000 settlers in Cyprus, while the legal and illegal foreign workers in Cyprus were about 18% of the population of the government-controlled areas! The corresponding figure in European countries is 8%. Even if the figure of 18% is an exaggeration still the respective figure is a double digit one! From the official statistics we may note the following: registered foreign workers in the government-controlled areas are already 22% of the labour force or 6,8% of the population. This could be higher if illegal workers are counted. Meanwhile estimates of the number of settlers in the north range from 120.000 (Turkish-Cypriot sources) to 180.000 (Greek-Cypriot sources).

on the other hand there will be competition. Cypriot consumers will benefit from this development as they will have more opportunities and options.

Labour Market

Following the reunification of Cyprus even within the framework of a bizonal bicomunal federal model, there will be multidimensional injections to economic activity. These include projects for reconstruction, provisions for (new) infrastructure and so on. Considerable activity can also be expected in relation to the territory that will be returned to Greek Cypriots. In relation to this, we cannot ignore that there will be great need for the resettlement of Turkish Cypriots who will move away from Greek-Cypriot properties. In addition, following the solution of the Cyprus problem it is also reasonable to expect considerable increase in the inflows of foreign direct investment.

Naturally all these developments will create high demand for labour in both component/constituent states. To the extent that markets move toward integration, this demand will be sustained with beneficial effects for all Cypriots. Under these circumstances we should not rule out that there may even be labour shortages, which may be covered by inflows from European and other countries.

Prices

Inevitably the reunification of Cyprus will lead to the creation of a larger market which will tend to generate price convergence. Prices in the Greek-Cypriot component/constituent state will tend to stabilize or even be slightly reduced while in the Turkish-Cypriot component/constituent state they will increase.³⁴ Reunification will also lead to changes at two levels: both relative and absolute prices. The greater the integration of markets and the economy as a whole, the greater the benefits for consumers.³⁵

Environment, Education, Health and Consumer Protection

In most federal states, both the central and the regional governments have competence in the areas of environment, education, health. To the extent that the federal model has a strong central government, the latter will play a more important role in these areas. Within the framework of a bizonal, bicomunal federal model, however, the two component/constituent states would have the more important role. If this is the case, the most likely outcome is that we may end up with two different levels and standards. This will not be a factor which consolidates integration.

³⁴ At least this should be the case for non-tradeable goods. For tradeable goods, there is evidence that food prices are actually higher in the northern part of Cyprus owing to the absence of competition. See F. Mullen, O. Oğuz and P. Kyriacou, *The Day After: Commercial Opportunities Following a Solution to the Cyprus Problem*, (PRIO, Cyprus Centre, Nicosia, 2008), p. 27.

³⁵ It should be noted that a process of some form of price convergence began in the period after April 23, 2003. If only some limited relationship led to a new dynamic, it is reasonable to expect that real integration will lead to economic convergence in all aspects.

An Overall Assessment

For a small country like Cyprus reunification makes economic sense. On the other hand, the particular form of solution will have a great impact on economic outcomes. The model of bicomunal bizonal federation as outlined in this chapter entails elements that will create positive repercussions for the economy, but also other elements that will be associated with negative developments.

Inevitably the return of territory to Greek Cypriots will create a huge wealth effect for the persons directly affected and the economy as a whole.³⁶ To the extent that restitution of properties is also acknowledged and the market role is extensively utilized, the overall impact will be positive. Furthermore, assuming that the resettlement of Turkish Cypriots is smooth, the positive effects will be sustained. Turkish Cypriots who had land in the southern part of the island will also greatly benefit from restitution and/or the role of the market in settling issues. Understandably, for Turkish Cypriots who will be resettled there will be provisions for new homes and arrangements for a new beginning.

On the other hand, problems may arise if the role of the market is not effectively utilized and if the principle of restitution is not recognized. In this case the forced compensation will not be adequate, bottlenecks will be created, and there will be a need for higher taxes to fund compensation. This would be damaging to Cyprus's small economy.

To the extent that bizonality is entrenched and is given priority, the three fundamental freedoms will be compromised. From an economic perspective this will hinder the process of economic integration. If such is the case we may have an economy of three speeds: one speed for each component/constituent state and one for the central government.

Under these circumstances it will be very difficult to sustain three governments: the central government and the governments of the two component/constituent states. If we also take into consideration the dimension of local administration then there will be greater propensity for high public spending. On the other hand, participation in the Eurozone has specific requirements. The EU will not allow Cyprus to have deficits indefinitely.³⁷ But even without the EU dimension high public spending as a percentage of GDP tends to undermine the dynamism of the economy.³⁸ This particular model, which in essence creates a three-headed state, may have problems of economic efficiency and long-term viability.

The legitimization process will certainly have a positive impact on the economy. If this process is also associated with a positive socioeconomic record, then the overall climate will

³⁶ The legitimization process will also be associated with a wealth effect for the whole economy. Problems will arise if the principle of restitution is not recognized and instead the method of compensations is pursued. Under these circumstances there will inevitably be higher taxes and many grey areas. These elements will have negative socioeconomic and political effects. On the other hand, if the principle of restitution is recognized and there is greater reliance on the market forces problems will be substantially reduced.

³⁷ As already noted, Charles Wyplosz made this point during a seminar organized by The Ministry of Finance of the Republic of Cyprus, entitled *Challenges inside the euro area: Life after 1/1/2008*, Friday, November 9, 2007.

³⁸ High public spending is already a damaging feature of the economy in the northern part of Cyprus. See World Bank "Sustainability and Sources of Economic Growth in the Northern Part of Cyprus", op. cit., p. vii.

improve and create conditions for sustained political stability. On the other hand, if the socioeconomic record is negative and especially if one or both communities feel that they are worse off, this will generate tensions and political turmoil.

In sum, this particular model does not generate the best possible economic results. To the extent that the suboptimal economic results produce a superior outcome than the *status quo*, this would be a positive development. However, there is a high risk that the strong bizonal elements will impede political and economic policy cooperation and in turn have a negative impact on economic performance. Therefore, if most people feel that this particular arrangement leads to a worsening of the situation, then the overall outcome would indeed be negative.

IV. SCENARIO B: STALEMATE/CONTINUATION OF THE STATUS QUO

Over the last few years there have been significant changes in both the specific characteristics and the overall nature of the stalemate and the *status quo*. Furthermore, the regional and broader geopolitical environment have also changed considerably. Despite its name, the *status quo* is dynamic in nature. In essence the characteristics of the regional and broader environment greatly influence economic outcomes.

The Major Characteristics of the Stalemate/Continuation of the *Status Quo*

Before April 23, 2003 the occupied northern part of Cyprus had limited links with the government-controlled areas of the Republic of Cyprus and the rest of the world. The dependence on Turkey was overwhelming whilst economic activity was subdued. Perhaps the only sector that was promising within the framework of an atmosphere of limited opportunities and overwhelming influence and control from Turkey, was the tertiary sector of education.¹ Moreover, prospects for the future were not bright. This led many Turkish Cypriots to seek a better life abroad, especially in the UK.²

Turkish Cypriots were aware of the situation in the government-controlled areas of the Republic of Cyprus. And although they tended to exaggerate the prosperity in the south, the undeniable fact was that Greek Cypriots could look forward to the future with optimism while Turkish Cypriots were very sceptical about the *status quo*.

GDP per capita in the northern part of Cyprus was lagging substantially behind the per capita GDP in the government-controlled areas.³ In 2001 per capita income in the northern part was only 25% of the corresponding figure in the government-controlled areas.⁴ It should

¹ W. Noë and M. Watson, "Convergence and Reunification in Cyprus: Scope for a Virtuous Circle", *ECFIN Country Focus*, op. cit.

² See A. Theophanous and Y. Tirkides "The Cyprus Economy in Perspective: an Analysis of Growth and Structure" in A. Theophanous and Y. Tirkides (Eds), *Accession to the Eurozone and the Reunification of the Cyprus Economy*, op. cit., pp. 70-73, and from interviews with Turkish Cypriots. On the other hand it must be noted that the number of those who permanently emigrated is disputed. See M. Hatay, "Is the Turkish-Cypriot Population Shrinking?", op. cit.

³ For interesting reading see W. Noë and M. Watson, "Convergence and Reunification in Cyprus: Scope for a Virtuous Circle", *ECFIN Country Focus*, op. cit.; M. Watson, and V. Herzberg, The Wolfson Cyprus Group Conference, "Sustainable Economic Development in Cyprus: Towards Economic Convergence and Reunification: The Case of the Northern Part of Cyprus", *Macroeconomic and Financial Frameworks*, op. cit.; A. Theophanous and Y. Tirkides (Eds), *Accession to the Eurozone and the Reunification of the Cyprus Economy*, op. cit., pp. 63-81.

⁴ *Ibid.*

also be noted that the northern part of Cyprus was repeatedly subject to economic and financial crises. More often than not these were imported from Turkey. This not only led to very limited opportunities but also created a vicious circle of a poor record, low expectations and high frustration.

On the other hand, Greek Cypriots seemed to be in a very good position. Accession negotiations of the Republic of Cyprus with the EU had started in March 1998 and one after another the chapters were closing successfully. Furthermore, there was sustained economic growth and job opportunities. Gradually there were also openings for professionals both in the public and the private sector. Gradually but consistently the economy was shifting to a service orientation which was also reflected in the labour market.⁵

Moreover, the government-controlled areas of the Republic of Cyprus were gradually integrated with the international economy. In stark contrast, the northern part of Cyprus was under the dominant and suffocating influence of Turkey in all areas – political, economic, social, cultural and military.⁶

The continuous inflow of settlers from Anatolia combined with the presence of the Turkish troops was transforming the overall landscape into a more or less Turkish province.⁷ Turkish Cypriots were not very happy with the state of affairs, and they also felt victims of isolation and of what they called Greek-Cypriot “embargoes”. Greek Cypriots, however, insisted that the Turkish-Cypriot predicament was an outcome of the occupation. The Republic of Cyprus had to defend legality; otherwise, the road to the legitimization of the “TRNC” would open.

The situation was destined to change with developments related to the final phase of the accession process and, moreover, with the Annan Plan.⁸ On March 9-11, 2003 the UN Secretary General failed to bring the two community leaders to an agreement. The blame fell on the Turkish side. On April 16, 2003 President Tassos Papadopoulos signed the Treaty of Accession of the Republic of Cyprus to the EU. There was jubilation among Greek Cypriots. Prospects were looking even better and hopes of a solution along the lines of the European value system were rising.⁹

⁵ It should be noted in this regard that while in 1980 the tertiary sector accounted for 45,7% of the gainfully employed, in 2005 the corresponding figure was 72,5%. See A. Theophanous and Y. Tirkides (Eds), *Accession to the Eurozone and the Reunification of the Cyprus Economy*, op. cit., p. 34. For more details see Department of Statistics and Research, Ministry of Finance, Republic of Cyprus. www.mof.com.cy

⁶ The title of a particular book by Ch. P. Ioannides, *In Turkey's Image: The Transformation of Occupied Cyprus into a Turkish Province* (Aristide D. Caratzas, New Rochelle NY 1991), is indicative of this situation.

⁷ See S. Bahcheli, “Census reveals soaring population in north”, *The Cyprus Mail*, 7 May 2006. Since then the inflow of Turkish settlers has continued.

⁸ For interesting reading see C. Palley, *An International Relations Debacle: The UN Secretary-General's Mission of Good Offices in Cyprus 1999-2004*, op. cit.; D. Hannay, *Cyprus: The Search for a Solution*, op. cit.; A. Theophanous, *The Cyprus Question: The Challenge and the Promise*, op. cit.

⁹ A. Theophanous, *The Annan Plan and the European Option* (in Greek), op. cit., especially pp. 81-87. See also Greek-Cypriot press on May 1, 2.

Turkish Cypriots felt that they were missing the boat for reunification and accession to the EU. And for them it was their leadership's fault. After all they had repeatedly demonstrated in massive numbers in favour of reunification and accession to the EU and against their leadership.¹⁰ The situation was tense in the northern part of Cyprus. The then Turkish-Cypriot leader Rauf Denktaş and Ankara understood that something drastic had to be done so as to improve the situation. At the same time it was important to also make gains in the international political arena.

On April 23, 2003 the Turkish-Cypriot leadership announced unilaterally the partial lifting of restrictions on the free movement of people on both sides of the green line.¹¹ What followed took by surprise even the most optimistic observers. Thousands of Greek and Turkish Cypriots travelled to the other side without any incident. One of the most fundamental pillars of Turkish policy was that the two communities could not live together and had to be kept apart. The developments that took place were not confirming this hypothesis. On the contrary, the opposite seemed to be true.¹²

It should be noted at the same time that the government of the Republic of Cyprus and the Greek Cypriots were caught by surprise. One of the questions raised was whether it was politically correct for the Greek Cypriots to show their passports in order to go to the other side. Some thought it mattered, some thought it did not and many more were confused.

In response to the opening, on April 2003 the government of the Republic of Cyprus announced a set of measures for Turkish Cypriots.¹³ These measures of the Cypriot government were a major step in the right direction; they included the provision of free medical services to Turkish Cypriots by public hospitals, access to the labour market and so on. Although these measures had been prepared long before April 23 it was the Turkish move that impressed the international community. The Cypriot government saw this move as part of a normalization process and reincorporation of Turkish Cypriots into the Republic of Cyprus.

Turkish Cypriots, however, had higher expectations. While many Turkish Cypriots took advantage of the measures, the Turkish-Cypriot regime saw these measures as an attempt for their 'absorption'. One criticism was that the Cypriot government was addressing Turkish Cypriots as individuals and not as a community.¹⁴ Yet the same package of measures could

¹⁰ Reuters, "Enough, nobody believes you..." Turkish Cypriot Rally Calls for Denktaş to Quit", 27 December 2002. See also H. Smith, "Cyprus Turks turn against their leader", *The Guardian*, December 19, 2003 and D. Hannay, *Cyprus: The Search for a Solution*, op. cit., pp. 225-227.

¹¹ As already noted Greek Cypriots and others who crossed were required to show passports (later national ID cards) and the movement could only take place through manned crossing points. Turkish Cypriots were required to show ID cards.

¹² According to D. Hannay, *Cyprus: The Search for a Solution*, op. cit., the "overall mood was festive" p. 225. Since 2003 there have been thousands of crossings on both sides. Even though since the end of 2005 there has been a gradual but steady decline in the crossings, a major conclusion or at least a hypothesis which may be derived is that under the right set of political circumstances, the two communities can live together.

¹³ <http://www.un.int/cyprus/pr4.30.2.htm>

¹⁴ The mainstream Turkish-Cypriot official view was that the word "osmosis" used by President Papadopoulos in his speech to the UN (New York, 18 September 2005), was indicative of his intentions. Perhaps, the term integration would have prevented misunderstandings.

have been announced with a community focus: the two were not easily differentiable. The Turkish-Cypriot criticisms would seem therefore to indicate a lack of trust and confidence.

Be that as it may, the post-April 23, 2003 situation was the beginning of a very important process, and one that has been transforming the broader landscape ever since. The northern part of Cyprus was experiencing the benefits of a degree of openness. Many Greek Cypriots and tourists visited the northern part of Cyprus and more money was spent there than ever before. This injection was crucial, as it signalled the beginning of an economic boom in the "TRNC." At the same time many Turkish Cypriots sought and acquired employment in the government-controlled areas. In 2006 full-time and part-time Turkish-Cypriot employees were initially estimated at around 10.000, although new data suggest the number might be closer to 7.000. Nevertheless, even the lower figure represents a substantial injection into the economy of the northern part of Cyprus.¹⁵ This situation has changed somewhat, with the number of workers decreasing to about 6.000 by the end of 2007. We note too that the number of crossings from both sides has also dropped substantially in the more recent period (see Appendix D).¹⁶

Gradually networks of cooperation beyond the traditional bicomunal activities were created between Greek Cypriots and Turkish Cypriots. And there was some reserved optimism among Greek Cypriots and Turkish Cypriots for a solution to the Cyprus problem that would coincide with the accession of Cyprus to the EU.

The characteristics of the *status quo* would change even more in the aftermath of the referenda on the Annan Plan V that took place on April 24, 2004; Greek Cypriots rejected it overwhelmingly (75,8%) while a strong majority of Turkish Cypriots (and settlers) voted Yes (65%). Irrespective of whether the Plan was balanced or not, outside impressions were dramatic: "It was the Greek Cypriots who rejected the UN Plan for reunification and it was the Turkish Cypriots [and the settlers] and the Turkish side in general who endorsed it." Furthermore, despite the position held by the majority of Greek Cypriots, i.e. that what was rejected was not reunification but a specific plan (which in their view was not balanced), the majority of Turkish Cypriots felt rejected.

President Papadopoulos and the Greek Cypriots were harshly criticized. More and more voices were becoming sympathetic to Turkish Cypriots. The issue now became not the occupation of the northern part of Cyprus by Turkey but the "isolation of the Turkish Cypriots."¹⁷

¹⁵ It should be noted that in 2003 there were 1.123.720 crossings by Greek Cypriots to the northern part of Cyprus, 1.173.825 in 2004, 1.319.899 in 2005, 897.044 in 2006 and 601.351 in 2007. At the same time the number of tourists visiting the "TRNC" increased. According to the "TRNC" "State Planning Organization" the number of tourists were as follows: 2002: 425.600, 2003: 469.900, 2004: 599.000, 2005: 652.800 and 2006: 715.700.

¹⁶ In relation to this it should be noted that the overall political climate in Cyprus has been negatively affecting relations between the two communities. If there is a major improvement of the political climate and there are also some confidence building measures most likely we will witness a substantial increase of crossings and the strengthening of networks of cooperation.

¹⁷ See for example the Report of the then UN Secretary General Kofi Annan to the Security Council immediately after the referenda <<http://www.un.org/News/Press/docs/2004/sc8116.doc.htm>>. In addition see "The Cyprus Stalemate: What Next?", Europe Report No. 171, *International Crisis Group*, op. cit., and "Cyprus: Reversing the Drift to Partition", Europe Report No. 190, *International Crisis Group*, op. cit.

For years Greek Cypriots had held the moral high ground and the Turkish side was blamed. In the aftermath of the referendum perceptions changed, at least in the short run. Although there was no recognition of the “TRNC,” Turkish Cypriots were receiving more support than ever before.

The Turkish-Cypriot community sought economic growth and development and convergence of living standards. They also wanted openness and the opportunity to integrate with the EU and the rest of the world (but not with/or via the Republic of Cyprus).¹⁸ At the same time the Turkish-Cypriot leadership and Ankara sought to achieve these objectives through the political upgrading of the “TRNC.” For example, in 2006, Turkey secured a change in the description of Turkish Cypriots at the Islamic Conference from “Cyprus Muslim Turkish Society” to “Turkish-Cypriot State” – the Turkish-Cypriot community’s putative name under the Annan Plan.

Within this broader political environment following the referenda, the exploitation of Greek-Cypriot properties in the occupied northern part of Cyprus took on unprecedented dimensions despite international law (case-laws establishing that titles remained with Greek Cypriots). At the same time the government of the Republic of Cyprus did not change its policy on Turkish-Cypriot properties in the government-controlled areas, a policy that respects in principle the ownership of property of Turkish Cypriots while maintaining these properties under the jurisdiction of a specific government agency due to the anomaly of the current situation.¹⁹ It should also be noted that some Turkish-Cypriot properties have been restored to their lawful owners.

We also note that some properties were sold by their lawful owners on both sides of the green line. The government of the Republic of Cyprus does not accept/encourage such actions in relation to properties in the northern part of Cyprus. But there were several cases of such transactions.²⁰ It remains to be seen whether this will become a process or will be limited to isolated incidents.

The Political Economy of the Stalemate/Continuation of the *Status Quo*

As already noted the characteristics of the stalemate influence to a great extent economic outcomes. And we have seen that following April 23, 2003 and subsequently April 24, 2004 a new political environment was created.

¹⁸ If there had been cooperation between the two communities and an understanding that relations between the Turkish-Cypriot community and the EU would not bypass the Republic of Cyprus, much would have been achieved. For example, it should be noted that financial grants from the EU were not utilized because the Turkish-Cypriot leadership wanted the overall deal to take place directly.

¹⁹ This issue is given special importance by the Republic of Cyprus. It is indeed indicative that in the Annual Report of 2006 the Auditor General raised several questions regarding issues related to the handling of Turkish-Cypriot property. See Auditor General, Annual Report 2006, pp. 720-723. <www.audit.gov.cy>

²⁰ The establishment of the property commission by the Turkish-Cypriot regime as an attempt to address ECHR decisions and to deal with the Greek-Cypriot property law suits further complicated the situation. As of December 10, 2007, 293 Greek Cypriots were reported to have applied to this commission. See Economist Intelligence Unit, Country Report Cyprus, January 2008, p. 16.

Property Issue

One of the striking characteristics of the post-April 24, 2004 situation was the intensification of the usurpation of Greek-Cypriot properties despite the illegitimacy of these actions. This led to the instigation of more court cases by Greek Cypriots. Inevitably issues have become more complex.

In contrast, in the government-controlled areas there has been no change of policy regarding Turkish-Cypriot properties. Furthermore, legal and other procedures have been respected. On several occasions the Supreme Court of the Republic of Cyprus has ruled in favour of Turkish Cypriots claiming their properties in the government-controlled areas.²¹

It must be noted that this situation has created scepticism and on some occasions bitterness among Greek Cypriots who feel that “Turkish Cypriots usurp Greek-Cypriot properties in the north, and claim their own in the south.” A sizable proportion of Greek Cypriots may prefer policies different than those pursued by the government.²²

Compensation

Given that there have been no territorial readjustments and no solution to the Cyprus problem, some people, both Greek and Turkish Cypriots, have decided to take action on their own within this particular political climate. Within this framework there have been some transactions involving properties on both sides of the green line. The government of the Republic of Cyprus pursues a policy which focuses on the legality of transactions taking place. This policy has been as a whole effective but naturally it could not stop people indefinitely from engaging in such transactions. Developments associated with the current situation have added more complexities to an already difficult situation.²³

Three Fundamental Freedoms

In the absence of a solution naturally the discussion over the three fundamental freedoms is influenced by the characteristics of the stalemate. Before April 23, 2003 mobility across the green line was extremely limited. More often than not, people would meet in the Ledra

²¹ For example, see the case of Arif Mustafa (*Politis*, February 17, 2006, p. 12, *Haravgi*, February 15, 2006, p.p. 1, 12, *Alethia*, February 14, 2006, p.p. 1, 3, *Alethia*, February 15, 2006, p.p. 1, 7).

²² One of the major conclusions that comes out of various interviews is the perception held by many Greek Cypriots that the policy of the government of the Republic of Cyprus in relation to Turkish Cypriots, a policy of reverse discrimination, does not lead to the expected outcomes. On the contrary it has led to a situation where “Turkish-Cypriots enjoy rights and benefits of the Republic of Cyprus without any obligations, while at the same time they enjoy the benefits of the northern part of Cyprus by Turkey”. The message is that policies should take into consideration the element of reciprocity.

This perception has not been affected by the change of government following Christofias' victory in the presidential elections of February 2008. It should also be noted that former President Papadopoulos was criticized for this issue.

²³ For example, the case of Tymbios is interesting; this is a case of a Greek-Cypriot who, after applying to the Turkish-Cypriot property commission, has agreed to exchange his property in the occupied northern part of Cyprus with Turkish-Cypriot land in the government-controlled areas. At the time of writing, the government of the Republic of Cyprus had not yet decided on whether it would allow the transaction to take place, since it (the government) disputes the legality of the property commission set up by the Turkish-Cypriot regime. In relation to the latest developments of this case, see *Politis* (Greek-Cypriot newspaper), January 20, p.p. 1, 4 and Greek-Cypriot press of February 12, 13, 2008.

Palace and the mixed village of Pyla inside the buffer zone and in foreign embassies over particular functions. It should also be noted that meetings also took place in other countries within the framework of seminars or round-table discussions organized by think-tanks or government agencies.

Following April 23, 2003 the situation as already noted had changed. But after the referenda developments in relation to the intensification of the usurpation of Greek-Cypriot properties has impacted on the flow/visits of Greek Cypriots to the northern part of Cyprus. The number of Greek Cypriots visiting has been greatly reduced in the more recent period. Indeed, many Greek Cypriots felt bitter and did not wish to put themselves in an uncomfortable situation. In this regard it has been reported that after one or two visits to the northern part of Cyprus, most Greek Cypriots changed their minds about going.²⁴ Only a small number of Greek Cypriots continue to visit.²⁵

In contrast, Turkish Cypriots continue to cross the green line to work, shop, or visit. The implication is that they feel more comfortable crossing to the 'other side'. Nevertheless, the number of Turkish Cypriots who cross and work in the government-controlled areas has also decreased considerably in the more recent period.²⁶

It should also be noted that in principle Turkish Cypriots may settle and buy property in the government-controlled areas of the Republic. Indeed, there are some Turkish Cypriots residing in the government-controlled areas. On the other hand, this does not hold true for Greek Cypriots.²⁷

Fiscal Policy

Under the current situation the Republic of Cyprus and the "TRNC" have pursued their own separate fiscal and economic policies. There does not seem to be adequate strategic thinking and preparation in relation to the possibility of a federal arrangement.

In its preparation to join the Eurozone, the Republic of Cyprus was successful in containing the fiscal deficit and meeting all the relevant criteria. Nevertheless much work is still required for a new philosophy of rationalization of public spending. In the "TRNC", however, there has not been a philosophy of restraint: budget deficits are still high and

²⁴ See the relevant Appendix D in relation to crossings of Greek Cypriots. In relation to this it should be noted that one of the conclusions derived from discussions with many Greek Cypriots who crossed over to the northern part of Cyprus is that after they had seen "the developments and the new realities", there is no desire to go again. These feelings and positions can only change in the event of drastic changes in the overall political climate.

²⁵ In the 2007 survey published by UNFICYP, only 1% of Greek Cypriots said that they cross frequently and 49% of Greek Cypriots said they had crossed only once or a few times but do not cross any more. See UNFICYP Survey 2007, "The UN in Cyprus: An Inter-communal Survey of Public Opinion by UNFICYP", (UNFICYP, Nicosia, 24 April, 2007), slide F. 1. <<http://www.unficyp.org/UNFICYP%20Survey.htm>>

²⁶ See relevant Appendix D. Some Turkish Cypriots too feel "that their presence is not particularly desirable by Greek Cypriots". It remains to be seen whether the victory of D. Christofias in the Presidential elections will substantially change the overall climate again.

²⁷ It should be noted that registrations of Turkish Cypriots (residing in the government-controlled areas) for the presidential elections of 2008 were around 300. This cannot be compared with the enclaved Greek Cypriots in the Karpasia Peninsula.

almost completely financed by Turkey. In the event of a solution it will take considerable time and effort for the northern part of Cyprus to streamline the fiscal indicators and also adjust the economy.²⁸

Legal Framework

The government of the Republic of Cyprus has been taking all steps leading to the implementation of legislation adopted in the process of the harmonization of laws and practices with the *acquis communautaire*. Consequently, the government-controlled areas are going through a process of change in all aspects; from business law, to health issues, to consumer rights and so on.

On the contrary, in the “TRNC” all aspects of life are influenced by the pervasive dominance of Turkey. In relation to the property issues as already noted there has been an intensification of usurpation of Greek-Cypriot properties.²⁹ This creates additional legal and other complications. It is evident that there is a fundamental problem of legitimacy.

Decision-making Process

At present, the government-controlled areas of the Republic of Cyprus function as a unitary state. Issues that would involve decisions within the framework of a bicomunal federal arrangement have not been raised or tested.

In relation to the “TRNC”, decisions are made within the framework of the parameters of the politics of the northern part of Cyprus. This means, among other things, that major decisions are subject to the approval of Ankara.

The real test for the decision-making process will come when there is a constitutional arrangement and a solution. Then Greek Cypriots and Turkish Cypriots will prove whether they can work together and share and exercise power within particular constitutional parameters.

The Economics of Development

Since the 1974 *de facto* division, the government-controlled areas of the Republic of Cyprus and the occupied northern part of Cyprus have been pursuing different paths of growth and development.³⁰ As already noted the parameters and broader characteristics of the

²⁸ See World Bank Report, “Sustainability and Sources of Economic Growth in the Northern Part of Cyprus”, Volume I: Economic Assessment, op. cit.

²⁹ There have been numerous reports in the press. See for example *Simerini*, February 11, 2006, p. 3, *Simerini*, February 19, 2006, pp. 22-23, *Phileleftheros*, October 7, 2007, p. 52. Even the 2008 Report of the International Crisis Group entitled “Cyprus: Reversing the Drift to Partition”, Europe Report No. 190, op. cit., refers to this issue, and recommends that the Turkish side should stop this practice.

³⁰ See A. Theophanous and Y. Tirkides “The Cyprus Economy in Perspective: an Analysis of Growth and Structure” in A. Theophanous and Y. Tirkides (Eds), *Accession to the Eurozone and the Reunification of the Cyprus Economy*, op. cit., pp. 19-81; W. Noë and M. Watson, “Convergence and Reunification in Cyprus: Scope for a Virtuous Circle”, *ECFIN Country Focus*, op. cit.; M. Watson, and V. Herzberg, The Wolfson Cyprus Group Conference, “Sustainable Economic Development in Cyprus: Towards Economic Convergence and Reunification: The Case of the Northern Part of Cyprus”, *Macroeconomic and Financial Frameworks*, op. cit.

³¹ *Ibid.* For interesting reading see also M. Watson, “Growing Together? – Prospects for Economic Convergence and Reunification in

stalemate have been transformed in the post-April 23, 2003 period. Currently the northern part of Cyprus has some interlinkages with the economy of the government-controlled areas. For example, under the green line trade regulation a small amount of goods is traded (across the green line). But the volume is small and this should in no way be seen as a substitute for reunification and integration.

During the period 2003-2007 per capita income in the north more than doubled in nominal terms and is now about 50% of per capita income in the government-controlled areas. There has also been a construction boom which further stimulated economic activity. Nevertheless, legitimacy issues are still present and persistent.

Despite drastic changes, the public sector has a dominant influence in the "TRNC" while the influence of Turkey remains overwhelming. As can be seen from the recent downturn in construction the stimulation of economic activity cannot be sustained indefinitely. Sustainable economic prosperity can be achieved, however, within the framework of integration with the economy of the government-controlled areas of the Republic of Cyprus and the EU. In this regard it should not be forgotten that much of the stimulation has been triggered by the economic linkages with the government-controlled areas (employment of Turkish Cypriots, Greek Cypriots spending in the "TRNC", tourists visiting the government-controlled areas also spending time and money in the north etc.)³¹ as well as the exploitation of Greek-Cypriot property.³²

In contrast, Cyprus met all the relevant criteria and on January 1, 2008 became a full member of the EMU. This may entail far-reaching changes not only for the government-controlled areas, but for the northern part of Cyprus as well. Indeed, the adoption of the euro as the national currency will have deep and far-reaching implications.

It should also be noted that with Cyprus as a member of the EMU a primary objective would be to move further toward real convergence. At the same time Cyprus will have to further diversify the productive base of its economy and become more competitive. Obviously there is a contrast with what is going on in the "TRNC".

Social Security Fund and Related Policies

Inevitably under the conditions of stalemate and the continuation of the *status quo* each side will continue to pursue its own policies. Not surprisingly, the relevant record of the government of the Republic of Cyprus is superior.³³ What may also be notable is that there has not been adequate thinking in relation to the possibility of a unified fund and common social policies in the event of reunification.

Cyprus", op. cit.

³² See F. Mullen, O. Oğuz and P. Kyriacou, *The Day After: Commercial Opportunities Following a Solution to the Cyprus Problem*, op. cit., pp. 25-26. Mullen also argues that the stabilization of the Turkish lira also played its role.

³³ For more details, see World Bank Report, "Sustainability and Sources of Economic Growth in the Northern Part of Cyprus", Volume I: Economic Assessment, op. cit.

It is also worth noting that the government of the Republic of Cyprus provides social security benefits to all those Turkish Cypriots who according to the relevant legislation fulfil the necessary criteria. In this regard it should be noted that over time many Turkish Cypriots have been beneficiaries of these policies despite the *de facto* partition and the associated realities.³⁴

Competition

Following April 23, 2003 there has been a greater economic relationship between the two sides in Cyprus. Nevertheless it is limited and, as noted, does not constitute a substitute for a reunified country. But it should be stressed that even this limited relationship has generated positive results, which may be indicative of what could happen if we move forward to a situation of real reunification.

Many Turkish Cypriots who worked/work in the government-controlled areas received/receive higher remuneration in relation to what they would have received as employees in the “TRNC”. And prices in all domains have increased in the northern part of Cyprus, due to increased demand from Greek Cypriots and tourists as well as from the substantial increase in income.

Local Administration

The stalemate has not allowed the creation of conditions of a reunified Cyprus in which local administration could be tried in a new political framework and landscape. Consequently, the issue of local administration has been dealt with, within the framework of the current political realities. In the government-controlled areas local administration is given much more attention than ever before. Given the influence of the respective institutions of the EU, the trend of its growing importance will continue. The future of local administration in the northern part of Cyprus under conditions of stalemate will be in line with other institutions and practices of the “TRNC”.

Settlers

Since 1974, and through the years of stalemate and the conditions after April 23, 2003 and especially after the referenda and the accession of Cyprus to the EU, the inflow of settlers has continued. It should be noted that this continued inflow is an outcome of four factors:

- (a) better economic conditions in the “TRNC” making it possible to absorb more labour and people in general;

³⁴ See research project entitled “*The Economic and Social Repercussions and Consequences from the Partial Lifting of Restrictions on the Freedom of Movement*” (in Greek), Cyprus Center for European and International Affairs, op. cit., pp. 47-61; See also http://www.moi.gov.cy/moi/pio/pio.nsf/measuresTC_gr/

- (b) the possibility of securing an EU passport following a solution or at least remuneration to “voluntarily” leave the island;
- (c) the fact that many Turkish Cypriots have been employed in the government-controlled areas has created openings in the north;
- (d) Ankara’s persistent policy to alter the demographic character of Cyprus.

The continued inflow of settlers makes the possibility of a solution to the Cyprus problem much more difficult to achieve. If Turkish Cypriots find it difficult, sometimes at least, to coexist with settlers, then it is understood that it may be much more difficult for Greek Cypriots to consent to their presence.

By the end of 2007 it was estimated by the authorities of the Republic of Cyprus that there were almost 180.000 settlers in the northern part of Cyprus. On the other hand, from a Turkish-Cypriot perspective settlers are estimated to be just over 116.000 according to the 2006 census. What is important to note, however, is that there is a continuous flow of people from Turkey to the northern part of Cyprus.³⁵

Immigration

From 1955 to 1973 71.036 Greek Cypriots and 16.519 Turkish Cypriots had left Cyprus seeking a better life abroad.³⁶ Following the cataclysmic events of 1974 thousands of Greek Cypriots looked for better opportunities in other countries. In the early 80’s many Greek Cypriots who had left the country in 1974 started to return.³⁷

With the economy in the government-controlled areas experiencing high growth rates over a long period of time, the need to allow foreign workers to be employed in Cyprus became pressing in the early 1990’s. This trend has continued and it is estimated that in 2007 there were more than 100.000 foreign workers, legal and illegal, in the government-controlled areas.³⁸ A new problem that the government of the Republic of Cyprus now has to address is illegal immigration. It has been reported that the bulk of foreign illegal immigrants come to the government-controlled areas from the occupied northern part of Cyprus.³⁹

It should also be noted that following 1974 around 40.000 Turkish-Cypriots gradually left Cyprus. This was mainly for socioeconomic reasons although political factors also played a role. And while economic conditions improved dramatically after 2003, it is unlikely that growth can be sustained in the absence of a normalized situation.

³⁵ There have been numerous reports in the Greek-Cypriot press in the last few years pointing out to this issue. See for example, S. Bahcheli, “Census reveals soaring population in north”, *The Cyprus Mail*, op. cit., *Politis*, February 16, 2006 p.p. 1, 6, February 15, 2007, p. 6, April 4, 2007, p. 5, *Alethia*, December 2006, p. 8, *Politis*, March 17, 2008.

³⁶ Ch. P. Ioannides, *In Turkey’s Image: The Transformation of Occupied Cyprus into a Turkish Province*, op. cit., p. 18.

³⁷ For interesting reading and understanding of the period and the socioeconomic processes see D. Christodoulou, *Inside the Cyprus Miracle: Labours of an Embattled Mini-Economy*, op. cit.

³⁸ See speech of Retired General Ph. Klokkaris (who also served as a Minister of Defense of the Republic of Cyprus), entitled *Threats to the Security of Cypriot Hellenism due to the Turkish Occupation*, op. cit.

³⁹ *Ibid.*

Foreign Workers

During the 1990's due to the mode of economic growth and development of the economy in the government-controlled areas there was an inflow of foreign workers. At the beginning this inflow was limited but gradually the numbers grew. Moreover, Cyprus has also been facing a problem of illegal workers. It seems that this trend will not be a temporary phenomenon.

Following accession to the EU there was another phenomenon: workers from the newly acceded central and eastern European and other countries also started to come to Cyprus in increased numbers. At the same time many Turkish Cypriots sought and acquired employment in the government-controlled areas on a full- or part-time basis.⁴⁰

The economy of the "TRNC" experienced a boom in the post-2003 period, which encouraged a further inflow of settlers from Turkey. It has also been noted that the employment of Turkish Cypriots in the government-controlled areas naturally created a substitution effect – in the sense that some vacancies were created which were filled by a new inflow of settlers. Nevertheless, given that the economy of the northern part of Cyprus was not enjoying full employment⁴¹ conditions, the substitution effect was not 1:1.

Under conditions of stalemate the situation became more complex and challenging, especially for the Republic of Cyprus. While the forces of change are multidimensional, the government cannot have an effective strategy to cover the whole territory of the Republic of Cyprus.

Tourism

Tourism has been one of the engines of growth for the Cyprus economy especially since 1974. Indeed this sector was instrumental in the 'economic miracle' as well as in the process of growth and development in Cyprus.

In relation to the northern part of Cyprus, due to the political situation and the particular socioeconomic circumstances, tourism did not reach its potential before 2003. Nevertheless after 2003 and especially after 2004, tourism in the broader meaning of the term started to grow. In addition to many Greek Cypriots who cross the green line to the northern part, more and more tourists spend time and money in the "TRNC". One could refer to three categories of tourists: (a) tourists who visit the government-controlled areas and decide to spend a short period of time in the northern part of the island; (b) tourists from Turkey; (c) tourists from countries other than Turkey who choose "TRNC" as their tourist destination.⁴²

⁴⁰ See the Report entitled *The Economic and Social Consequences and Repercussions from the Partial Lifting of Restrictions on the Freedom of Movement*, (in Greek), Cyprus Center for European and International Affairs, op. cit. Initial estimates placed the number of Turkish Cypriots working in government-controlled areas either on a full-time or part-time basis at 10.000. However, by the end of 2007 their number dropped to around 6.000.

⁴¹ The reported unemployment rate in the northern part of Cyprus is only around 1%. But this disguises large under-employment and a bloated public sector. The World Bank estimated the unemployment rate at 9,4% in 2004. See World Bank Report, "Sustainability and Sources of Economic Growth in the Northern Part of Cyprus", Volume I: Economic Assessment, op. cit., p. 18.

⁴² See footnote 15 in this chapter.

It should also be mentioned that with the increasing exploitation of Greek-Cypriot properties there has been growth in the number of foreign expatriates residing in the “TRNC”.⁴³ There have also been cases of foreigners who either bought Greek-Cypriot homes or the house they bought was built on Greek-Cypriot property, and they ended up in court.⁴⁴

Thus, following April 2003 and the referenda in April 2004 as well as Cyprus’s accession to the EU, the “TRNC” has had much better prospects for the growth of tourism. Nevertheless, the tourist sector also has its problems and this is no substitute in relation to the solution of the Cyprus problem and the benefits that may be associated with it. It can be expected that a solution to the Cyprus problem would lead to a substantial increase in tourism, with positive results for the economy of the country.

Labour Market

Up until April 2003 there were very few or no interlinkages between the labour markets of the two economies. Developments, following 2003, affect directly and indirectly the labour markets both in the government-controlled areas and the economy of the “TRNC”.

More and more Turkish Cypriots had sought and acquired jobs either on a part-time or full-time basis in the government-controlled areas. As already noted, it had been initially estimated that at times this number approximated 10.000. In the latter part of 2007 about 6.000 Turkish Cypriots worked on a full- or part-time basis in the government-controlled areas.

Obviously this development was associated with several other related effects. Even with only a few thousands working in the government-controlled areas, this translates into tens of millions of euros annually. There was a substantial increase of incomes which not only improved the standards of living of these workers but also acted as an injection for the Turkish-Cypriot economy.

At the same time as the “TRNC” was experiencing an economic boom, incomes grew further and many more jobs were created. One should also not underestimate the substitution effect that was experienced. As more and more Turkish Cypriots sought and acquired employment in the government-controlled areas many vacancies were created in the “TRNC”. These were covered mostly by a new wave of Anatolian settlers.

The interlinkages in the labour market as well as in other domains between the two economies generated important developments including spillover effects. Turkish Cypriots spent money in the government-controlled areas.⁴⁵ In addition to the immediate economic effects (increase of the demand for goods and services in the government-controlled areas)

⁴³ For example, see *Phileleftheros* (on line), November 25, 2007.

⁴⁴ See “Can the Prime Minister’s Wife Save this Holiday Home?”, *Telegraph Online*, January 25, 2006; See also, “Orams v Apostolides” Case, *Lobby for Cyprus*, September 8, 2006; Also see Statements by Government Spokesman, (in Greek), *Cyprus News Agency*, September 6, 2007.

⁴⁵ According to the Credit Card Company, JCC, CYP9 million was spent using Turkish-Cypriot cards in the government-controlled areas in 2007.

there are other clear socioeconomic and political implications. Undoubtedly, the market may be a major unifying factor. It should come as no surprise that the Turkish-Cypriot leadership tried in the latter part of 2007 to stop Turkish Cypriots from purchasing goods and services in the government-controlled areas.⁴⁶ In this regard, Greek Cypriots have noted that there is a contradiction in the assertion of the Turkish-Cypriot leadership that Turkish Cypriots are isolated by Greek Cypriots while at the same time the regime attempts to stop them from purchasing goods and services in the government-controlled areas. Along the same line of thinking, Greek Cypriots suggest that many Turkish Cypriots are not only working in the government-controlled areas but enjoy other benefits as well. Furthermore, we also noted that to the extent that there is Turkish-Cypriot isolation, it is an outcome of the occupation of the northern part of Cyprus by Turkey.

Prices

Before April 2003 there was a huge gap in price levels between the two economies, a gap which was reflecting the difference at all levels. In the aftermath of the partial lifting of restrictions to free movement and also after the referenda and the accession of Cyprus to the EU, there has been a greater degree of interlinkages between the two economies. Despite the fact that these contacts had their own limitations, there began a process which substantially reduced the gap between price levels in the two economies.⁴⁷

The differential in restaurant and retail price levels was reduced, while at the same time the prices of land in the northern part of Cyprus increased significantly.⁴⁸ These developments may be indicative of the potential for economic convergence in the event of a solution based on principles of integration rather than division.

Environment, Education, Health and Consumer Protection

Inevitably under conditions of the *status quo* different policies were pursued by the two sides. In the post-2004 period, the Republic of Cyprus as a member of the EU has been affected by European policies, directives, and practices regarding the issues of environment, education, health and consumer protection.

In relation to the “TRNC” it should be noted that there has been more acceptability of Turkish-Cypriot institutions in the European and international context than ever before. More and more Turkish-Cypriot tertiary educational institutions have developed links and

⁴⁶ See, for example, *Simerini*, November 24, 2007, p.p. 1, 10 and November 30, 2007, p. 31.

⁴⁷ It should be noted that according to F. Mullen, O. Oğuz and P. Kyriacou, *The Day After: Commercial Opportunities Following a Solution to the Cyprus Problem*, op. cit., p. 27, food prices in the government-controlled areas are lower.

⁴⁸ See S. Platis, S. Orphanides and F. Mullen, *The Property Regime in a Cyprus Settlement: A Reassessment of the Solution Proposed under the Annan Plan, Given the Performance of the Property Markets in Cyprus, 2003-2006*, op. cit., pp. 40-46.

interlinkages with the outer world. And particular EU programmes are targeted with the objective of helping Turkish-Cypriot students.⁴⁹

Furthermore, it should be noted that following the package of measures of the government of the Republic of Cyprus, Turkish Cypriots have been enjoying access to, and free medical services in, public hospitals in the government-controlled areas.⁵⁰ It has also been reported that many Turkish Cypriots also visit medical specialists and private hospitals and clinics in the government-controlled areas.

In relation to environmental issues, it should be noted that before 2003 the northern part of Cyprus had in essence avoided the unplanned and massive tourist growth and development process with its excesses that the government-controlled areas had gone through. Following 2003 and especially 2004 the exploitation of Greek-Cypriot properties was intensified. This is also having an impact on the northern part of Cyprus which is reminiscent of the experiences in the government-controlled areas with regard to tourism and construction without constraints and/or regard for the environment.

An Overall Assessment

Before 2003 there was a huge gap between the government-controlled areas and the “TRNC” in all aspects. The ratio of per capita income was about 1:4; furthermore, economic structures and prospects were different. Despite particular structural problems in the government-controlled areas the economy was gradually and successfully integrating with the European and international economy. The degree of openness was satisfactory and there were good reasons to look forward to the future with optimism.

On the other hand the economy of the “TRNC” was heavily dependent on Turkey. Furthermore, it was based on a statist model and there were problems of efficiency in all aspects. At the same time, issues of legitimacy were pressing, and there were questions of sustainability. The socioeconomic conditions were such that many Turkish Cypriots chose to emigrate for a better future.

Following 2003 and 2004 there were developments that changed the parameters of the *status quo*. Besides the economic boom and the substantial improvement in living standards there were openings and opportunities provided by the Republic of Cyprus and the EU.

Many Greek Cypriots feel that at this particular time Turkish Cypriots have the best of two worlds. They have more rights in the Republic of Cyprus than before and few or no

⁴⁹ The European Commission put forward, on 7 July 2004, a proposal for a Council Regulation on an instrument of financial support for encouraging the economic development of the Turkish Cypriot community. The financial statement which accompanied this proposal provided for €259 million to be committed to this programme over the period 2004-2006 under Heading 7 (Preaccession strategy) of the Financial Perspective. This led to Council Regulation (EC) No 389/2006 adopted on 27 February 2006 establishing an instrument of financial support for encouraging the economic development of the Turkish Cypriot community.

⁵⁰ See the Report entitled *The Economic and Social Consequences and Repercussions from the Partial Lifting of Restrictions on the Freedom of Movement*, (in Greek), Cyprus Center for European and International Affairs, op. cit., especially p. 75.

obligations. Moreover, no land has been returned to Greek Cypriots; in contrast, the usurpation of Greek-Cypriot properties has taken unprecedented proportions.

Consequently, the hypothesis that has been put forward is that the *status quo* is undesirable for Greek Cypriots but preferable for Turkish Cypriots. This should also be seen within the framework of Turkish efforts to further upgrade the “TRNC” within the framework of the policy of “ending the isolation of the Turkish Cypriots”.

In this regard it has been a major Greek-Cypriot position that the upgrading of the “TRNC” would reduce substantially the incentives of Turkish Cypriots to work constructively towards a solution of the Cyprus problem.⁵¹ This assessment may be contrasted with the situation before 2003, when Turkish Cypriots were fervently demonstrating in favour of reunification and accession to the EU.

⁵¹ This is one of the main reasons of the opposition of the Republic of Cyprus to the EU's proposed direct trade regulation, (which would in effect legitimize Turkish-Cypriot/occupied ports and airports).

V. SCENARIO C: TWO-STATE SOLUTION

The Major Characteristics of a Two-State Solution

Although the possibility of a velvet divorce or a two-state solution has been considered/raised unofficially from time to time, there has never been a systematic effort to comprehensively describe the characteristics of such an outcome.¹ Within the framework of this research project, we will attempt to outline particular characteristics and outcomes of such a solution.

Two Completely Independent States

The agreement would involve mutual recognition and the simultaneous return by the Turkish side of part of the land occupied in 1974. This may be described as a deal based on the principle of “land for recognition”. The two states would be sovereign with internationally recognized borders. Bicommunality would no longer be a factor in the constitutions of the two states; it is understood that the two states, the Republic of Cyprus and the “TRNC”, would reform their constitutions accordingly.² That means that the two states would each function on the basis/philosophy of a unitary state.

Territorial Issue

As noted above, the overall agreement will be based on the principle of “land for recognition”; that means that the Republic of Cyprus will recognize the “TRNC” as an independent state in exchange for land returned. Subsequent to the agreement, the Republic of Cyprus will have 72,5% of the territory and the “TRNC” 27,5%.³ Mutual recognition and the return of land will take place simultaneously.

¹ There were suggestions pointing out that a two-state solution was less painful than a bizonal bicommunal federation with elements of both federation and confederation. For example, see Y. Valinakis, “A Bold Proposition for Cyprus” (in Greek), *Kathimerini* (Athenean daily newspaper), op. cit.; St. Lygeros, *On the Brink of Extinction* (in Greek), op. cit.; A. Theophanous, *European Cyprus: Constitutional Structure Economy and Society. Accession and Solution Scenaria* (in Greek), op. cit., pp. 195-203. It should be noted that H. J. Gobbi, *Rethinking Cyprus*, op. cit., is based on confederation and not complete separation.

² In such a case the Republic of Cyprus has to reform its constitution to a much greater extent as it is based on bicommunalism. The constitutional provisions of the “TRNC” may not need a major change.

³ There have been different ideas and suggestions in relation to the territorial issue. In relation to the Ghali Set of Ideas the suggestion was that the area under Turkish-Cypriot administration would be 28,4%; in the Annan Plan it was 29,2%. In the past it was suggested that in the case of complete separation more land would be returned to the Greek Cypriots (75%-25%). See H. J. Gobbi, *Rethinking Cyprus*, op. cit., p. 49. Again it is noted that H. J. Gobbi's proposition amounted to a confederation.

The Issue of Guarantees

The system of guarantees embedded in the 1960 constitution will cease to exist. Turkey, Greece and Britain will no longer be guarantors; instead, there will be a new system to guarantee the new state of affairs.⁴ At the same time there will be a process by which changes can be made following an agreement between the two states in Cyprus. That means that although a two-state solution will be agreed, the dynamics of the day after may lead to new forms of cooperation. Theoretically the option of reunification in the distant future cannot be ruled out.

The Issue of the Sovereign Bases

Within the framework of this agreement the sovereignty of the British Bases will come into question. It can be argued that the area of the British Sovereign Bases should be returned to the Republic of Cyprus. Ultimately, however, it will be up to the Republic of Cyprus to decide on this issue. If the Bases remain and continue to operate, it will be under a different system/framework of operation.⁵

Property Arrangements

It is assumed that the principle of “global” exchange of properties will prevail under the two-state solution.⁶ Greek Cypriots who have property in the area that will be returned to the Republic of Cyprus benefit immediately, while those Greek Cypriots who have properties in the area that will constitute the “TRNC” will be encouraged to accept an exchange of properties and/or compensation. The same principle will apply to Turkish Cypriots who have properties in the territory of the Republic of Cyprus.

For this particular arrangement, foreign assistance for compensation purposes will be of utmost importance.⁷ In the probable event that exchange of properties and foreign contributions for compensation are not adequate, the two-state solution should incorporate clauses for compensation purposes. Indeed, there should be a comprehensive policy for equity purposes.⁸

⁴ In relation to this there are several ideas; these include the participation of Cyprus in NATO. (From interviews with Greek-Cypriot and other diplomats and academics).

⁵ Given that the Bases were part of the process which led to the establishment of the Republic of Cyprus in 1960, with the change of the state of affairs the status of the Bases would also change. For interesting reading see A. Theophanous and Y. Tirkides (Eds), *Reflections on the Relations Between Britain and the Republic of Cyprus and the Case of the British Sovereign Base Areas*, (Intercollege Press, Nicosia 2007).

⁶ Within the framework of a two-state solution it is expected that the Turkish-Cypriot side would like to have control of the ownership of land. Perhaps this may change if new circumstances are created; for example, if the “TRNC” embarks on a process of Europeanization and/or federalization with the Republic of Cyprus and confidence and trust between the two sides are established, then the relevant provisions may change.

⁷ For this purpose, the UN, the EU, the US and the international community may work in ways to accommodate the setting up of such a fund. It is understood though that at a time of scarce resources and unlimited wants the fund that will be raised will not be adequate.

⁸ The state may use state and church land for this purpose. Alternatively it may also impose a specific property tax for a period of time so that arrangements that will be made will create the feeling of relative equity under the circumstances.

Relations between the two States

In the aftermath of a two-state solution there are several potential scenarios regarding the framework of relations between the two states. At one extreme, there may be a period of “Cold War” during which relations will be minimal. Under these circumstances, the citizens of the two states may even need visas to cross to the other side. Within the framework of this pessimistic scenario, most likely the “TRNC” will continue to depend heavily on Turkey.⁹ At the other extreme, its new legal status as an independent state will enable the “TRNC” to promote its relations with the EU and the rest of the world.

In the optimistic scenario the two states will cooperate. There would be freedom of movement (no visa requirements) and the opportunity for business networks to develop. Within the framework of this model it may also be possible for the two sides to engage in negotiations for economic, political and social cooperation. Would it be possible for the two sides to seek reunification? This cannot be ruled out; but such an outcome would be the end result of a long process in which cooperation leads to mutual gains, and confidence and trust between the two sides become a major characteristic of the political and social landscape of Cyprus. Obviously the EU will play a crucial role as will Turkey. Would Turkey allow developments in Cyprus that would advance integration?¹⁰

The Political Economy of a Two-State Solution

Property Issue

Within the framework of a two-state solution, as already noted, the principle of “global” exchange will be adopted and implemented. Consequently the principle of restitution will not apply. As regards the land that will be returned to the Republic of Cyprus, obviously all Greek-Cypriot rightful owners will have their land and properties back.

For those Greek Cypriots whose land and properties will be in the area that will constitute the recognized state of the “TRNC”, there will be no restitution. However, they may instead exchange land with Turkish Cypriots who own land and properties in the Republic of Cyprus. Furthermore, since there is more dispossessed Greek-Cypriot property than dispossessed Turkish-Cypriot property, it is hoped that European and international donors will contribute to and assist in the exchange and compensation.¹¹ Further, the government of the Republic of Cyprus must take all necessary steps so that victimization is prevented, or at least limited, and so that a feeling of (relative) equity, given the constraints, prevails.

⁹ After April 23, 2003 the relative dependence of the “TRNC” on Turkey may have decreased, although it is still overwhelming. The question that should be raised is to what extent Turkey is willing to allow the “TRNC” to act independently.

¹⁰ This question raises the issue of the potential stance of Turkey on Cyprus. So far Turkey has not shown that it is ready to let Cyprus go. For example, Turkish high officials continually stress that Cyprus is an issue of national security for Turkey.

¹¹ It should be remembered that before the referenda there was in Brussels a donors’ meeting to raise funds for compensation. See also J. Christou, “Money pledged to reunify Cyprus”, *Cyprus Mail*, April 16, 2004.

This arrangement is not optimal. Nevertheless, it will generate a huge wealth effect for Greek Cypriots, while Turkish Cypriots may also experience a wealth effect – albeit of a much lesser intensity – despite the return of some land to Greek Cypriots; this will be due to the legitimization process. This arrangement also means that a sizeable portion of the “TRNC” population will have to be relocated due to land being returned to Greek Cypriots. The cost of such relocation will create strains,¹² but assistance from the EU and the international community will help alleviate those strains. All in all, this arrangement will entail a wealth effect for the “TRNC”, despite the return of land. The legitimization process will permit the optimal utilization of resources and also promote the necessary conditions for sustained growth and development.

Compensation

In this particular model, where restitution is not the guiding principle for the property arrangements, the compensation policy that will be adopted will be of utmost importance. Obviously, the Greek Cypriots who will not receive their properties back will seek exchanges with available Turkish-Cypriot properties in the southern part of the island. To the extent that this will give win-win outcomes it will be satisfactory.

For those who will not receive land or other property in exchange, the next best alternative would be adequate and effective compensation. Towards this end it will be necessary for an international fund to be set up. Additionally, the government of the Republic of Cyprus must formulate a comprehensive policy to ensure an equitable outcome.

By the same token it will be necessary to provide help for the relocation of Turkish Cypriots. In this case as well, international financial support will be essential.

To the extent that all necessary international financial aid both for compensation purposes as well as for relocation is secured, taking all relevant factors into consideration, there will be a considerable wealth effect. If external funds are inadequate to cover the necessary expenses, other arrangements will have to be made.¹³

Three Fundamental Freedoms

Within the framework of two independent states the issue of the three fundamental freedoms and their implementation becomes irrelevant. It will be up to the two states to formulate relevant policies. As already noted there are different possibilities: in the pessimistic scenario, citizens of the two states as well as tourists may have to show passports or even obtain visas to cross to the other side; in the optimistic scenario, citizens may cross or even seek employment with very minimal procedures.

¹² Within the framework of such a process many jobs will also be created.

¹³ As already noted: see footnote 8.

One thing is certain at least at the beginning: the freedom to settle and to hold property throughout the island will not apply. Whether in the long run and after a period of sustained cooperation, new circumstances and conditions will make this possible is another issue. But it may be reasonable to expect that the freedom of movement of people will apply with minimal procedures.

Fiscal Policy

Obviously within the framework of a two-state solution each independent state will pursue its own fiscal policy. The Republic of Cyprus, as a member of the EU and of the EMU, will have particular obligations in relation to maintaining fiscal discipline. In addition, the Republic of Cyprus will take steps toward economic convergence with the rest of the EMU members at all levels.

It will be uncertain how the “TRNC” will address the issue of fiscal policy and convergence. If it continues to operate under the umbrella of Turkey it will be difficult to move toward radical changes – such as fiscal reform and less government interference in the economy. If, on the other hand, it moves toward a path of harmonizing with the *acquis communautaire* with the objective to become part of the EU as an independent state or even within the framework of federalization with the Republic of Cyprus, then economic variables and circumstances will eventually change.

In the event of minimum cooperation between the two states, the most likely outcome is that the divergence between the Republic of Cyprus and the “TRNC” in the fiscal domain as well as on broader relevant issues will continue to persist or even become greater. In the long run this will contribute to a sustained and growing gap between the two sides. Under these circumstances Turkish Cypriots may question and/or reconsider their options.¹⁴

Legal Framework

In a two-state solution we cannot expect that the legal framework for economic, social, health and other issues will be the same. The Republic of Cyprus will continue to work toward real convergence with the EU. The challenging question is how the “TRNC” will act. Again, the key issue is whether it will remain anchored to Ankara or will try to move in the direction of Europeanization. If the strategic option is toward modernization and Europeanization, then it may be expected that this will create an additional channel of cooperation between the two states in Cyprus.

¹⁴ The question of full absorption by Turkey may be an option unless other arrangements are made. Perhaps the same applies to the Greek Cypriots and the Republic of Cyprus in relation to a revisited option regarding relations with Greece.

Decision-making Process

Within the framework of a two-state solution each state will make its own decisions given its own constraints and possibilities. That implies that the bottlenecks and the disagreements that may exist in a federal, confederal, or consociational arrangement will be avoided.

The Republic of Cyprus will have obligations stemming from its membership in the EU and the EMU, and will make decisions accordingly. On the other hand, the decision-making process in the “TRNC” will be influenced by the strategic options and choices that it will make and, moreover, by the degree of its dependence on Turkey. If circumstances allow the “TRNC” to pursue an independent course and it chooses to move along the lines of modernization and Europeanization, then there will likely be scope for cooperation between the two sides on the island.

The Economics of Development

As a member of the EU and the EMU, the Republic of Cyprus will follow its own path of growth and development, focusing largely on real convergence with the rest of the EU. Insofar as the solution of the Cyprus problem will be associated with territorial and property arrangements, there will be numerous and multidimensional benefits, including a huge wealth effect. Thus, it is reasonable to expect that the Republic of Cyprus will embark on a long period of robust growth and further development.

The solution of the Cyprus problem will also be a positive development for the “TRNC” despite the return of land to the Republic of Cyprus. A major contributing factor to this would be the legitimacy that the settlement will confer on the “TRNC”, and the subsequent normalization of relations with the Greek state in Cyprus and the rest of the world. To the extent that the “TRNC” aims at modernization and Europeanization its prospects will be greatly enhanced. In the event that it remains dependent on Turkey prospects will be more problematic.

Social Security Fund and Related Policies

Within the framework of a two-state solution inevitably the issue of the Social Security Fund and the related policies will be dealt with exclusively by each state. The expected outcome, based on the current situation, is that the Republic of Cyprus will have a superior package. If the socioeconomic gap between the two sides grows even larger, then naturally this will also be reflected in the relevant social schemes and policies of the two states.

It is possible that sustained differences in the level of economic development and in the provision of social services may generate scepticism among Turkish Cypriots about the wisdom of separation. If the “TRNC” is in a position to make independent decisions, it may reassess its overall strategy and seek cooperation with the Republic of Cyprus in all aspects.¹⁵

¹⁵ Some analysts may see this scenario as wishful thinking. If this hypothesis is right, many others may think likewise in the case of a bizonal bicomunal federation. In other words, if cooperation in a two-state scenario is wishful thinking then perhaps it may also be wishful thinking to expect cooperation between the two constituent states of a bizonal bicomunal federation similar to the one envisaged by the Annan Plan.

Competition

Competition naturally would have been stronger within the framework of a unified state than under the two-state scenario. Nevertheless, to the extent that different relationships and networks are created between the two states, competition would be enhanced. For example, if citizens of the two states can shop throughout the island the forces of competition will operate. More generally if capital and labour are allowed to move freely, the economic outcome will be more efficient than if impediments are put in place.

From another perspective the two states may compete in relation to tourism, tertiary education and other services. One potential byproduct of this competition is that prices could be comparable while both sides aim to improve quality. However, there is also the possibility that eventually, if economic dynamics are allowed to operate, more cooperation will result. Indeed if cooperation evolves out of voluntary processes it will be sustainable. But it must be stressed that for a country the size of Cyprus, it is counterproductive to have two separate states and economies. Perhaps this will eventually be understood; indeed, it is possible that this issue will be raised by both Greek Cypriots and Turkish Cypriots. This in its turn may open other possibilities, from upgrading cooperation to unification into a single federal state.

Local Administration

Inevitably, within the framework of a two-state solution, the two sides will pursue their own paths regarding local administration. The Republic of Cyprus will be much more influenced by relevant developments in the EU in this domain. Furthermore, given that participation in the EMU requires fiscal discipline there will be a rethinking of how resources are efficiently utilized. With these constraints it may be possible for new ideas to be implemented – such as the integration of some services in order to create larger units of local administration.

Developments in the “TRNC” will be influenced by the particular path that will be pursued. Generally if further modernization and Europeanization are chosen, then local administration will be addressed accordingly. If, on the other hand, the Turkish model is applied, then practices similar to those in Turkey will prevail.

Settlers

One of the major issues of the Cyprus question has been the settlers, an issue that has been exacerbated over time. In a two-state solution, it will be up to the “TRNC” to address the issue. The most likely outcome is that all settlers will be legitimized and become citizens of this state. Following recognition there are different scenaria. At the one extreme, Turkey may sustain this policy with the objective of further increasing the mainland Turkish population of the “TRNC”. Such a scenario/development entails far-reaching socioeconomic and political implications. For example, a sizeable number of Turkish Cypriots may prefer to live in the Republic of Cyprus. Of course, the Republic of Cyprus will not be obliged to offer residency or citizenship to Turkish Cypriots.¹⁶

¹⁶ Such a potential stance may be understandable. On the other hand if there is an air of cooperation between the two sides then the whole issue may be revisited by both sides.

On the other hand, the “TRNC” may exhibit self-reliance and pursue a policy of modernization and Europeanization that will contain any further inflow of people from Anatolia. After all, this would be a natural process of development.¹⁷

The final outcome of this issue will certainly influence further developments on the island. The continuing inflow of settlers, considering the historical and political dimension, will create serious difficulties for the prospects of cooperation between the two states.

Immigration

Immigration will be a domain over which the two independent states may exercise their own separate policies. Again, in this domain there are several scenarios; the two extreme scenarios entail on the one hand full cooperation and on the other hand completely independent courses of action. Citizens of EU member states will have the right to seek employment or also settle in the Republic of Cyprus (e.g. as retired pensioners). In relation to citizens of third countries it is expected that the Republic of Cyprus will continue to face similar challenges as the EU countries – that is, it will be an attractive destination or at least it will be used as a stepping stone for immigration to the heart of the EU.

If the “TRNC” pursues a modernization and Europeanization path it will also be a potential attractive destination. If on the other hand, the “TRNC” is under the dominant influence of Turkey, developments should be seen in relation to the issue of settlers. It should also be noted that in the case of antagonistic relations between the two states, the “TRNC” will be used more often by illegal immigrants to enter the Republic of Cyprus.¹⁸

Foreign Workers

In the case of the Republic of Cyprus, citizens of all EU countries will have the right to enter and seek employment. Citizens from third countries will be able to acquire work permits when particular prerequisites are fulfilled. But the most important factor influencing the demand or flow of workers will be the state of the economy. In this regard it must be noted that following a solution within the framework of this scenario there will be an economic boom. Conditions of full employment will be created and the possibility of additional job vacancies cannot be ruled out.

An economic boom in the “TRNC” will also create conditions of near full employment, although it is unlikely that there will be a sustained need for foreign workers. To the extent that Turkish Cypriots successfully seek employment in the Republic of Cyprus, it is possible that a substitution effect will be created; that is, a great proportion of Turkish Cypriots who will be employed in the Republic of Cyprus will be replaced by Turkish and other foreign workers.

¹⁷ The assumption is that it is rational to expect people to maintain a particular level of living standards. This may mean that the growth of population must be kept within particular limits.

¹⁸ Currently most illegal immigrants come to the government-controlled areas via the occupied northern part of Cyprus. See also speech of Retired General Ph. Klokkaris entitled *Threats to the Security of Cypriot Hellenism due to the Turkish Occupation*, op. cit.

Tourism

Tourism will be a very important sector for the economies of both states. Following the return of land to Greek Cypriots, naturally there will be an expansion of the tourist product. For the “TRNC”, despite the return of land, the legitimization process would also enhance tourist prospects and the prosperity of the economy as a whole. Tourism will continue to be the most important sector of the economy.

As already noted, there are different possibilities regarding the prospect of cooperation with Greek-Cypriot interests and stakes. In such a case Turkey could be a new huge market for the Republic of Cyprus. And distant markets would be utilized by joint ventures.¹⁹ At the same time, the two states may also find themselves competing in this domain. Such competition may lead to a form of price convergence and also efforts to upgrade quality. All in all, tourism will expand on both sides of the island with beneficial results for the economy. It is not an exaggeration to suggest that up to 5.000.000 tourists may visit Cyprus as a whole annually.²⁰

Labour Market

A solution to the Cyprus problem in the manner described would lead to the creation of new jobs in both states. Perhaps the Republic of Cyprus will experience a much stronger boom; on the other hand, we should not underestimate the benefits of the legitimization process for the Turkish-Cypriot state and its economy. We note, however, that a scenario of reunification and economic integration would produce much greater benefits, especially for the Turkish Cypriots.

Employment conditions, including salaries, will be higher in the Republic of Cyprus at least for a period of time. There will be a strong drive among Turkish Cypriots to seek employment in the Republic of Cyprus. Whether this demand will be met will depend on the level of cooperation between the two states. Absence of cooperation may lead to a sustained socioeconomic gap between the two states, while true cooperation may pave the way for a step-by-step process toward a form of federalization.

Prices

Under reunification, gradually, there would be a process of price convergence at all levels. Indeed, after 2003 there was a process of closing of the economic gap between the two sides including that of the price level – and this despite the fact that the situation was not normalized and there were only some forms of economic interrelationships. With a two-state

¹⁹ For example tourists from the US and Japan could be offered packages involving Greece, Turkey and Cyprus and/or even countries in the Middle East.

²⁰ In 1992 the then President Vassiliou stated that in the case of a solution on the basis of the Ghali Set of Ideas there would be expansion of the tourist sector. He specifically mentioned the possibility of 5 million tourists visiting Cyprus annually in the aftermath of a solution. See G. Vassiliou, “Prospects for a federal solution of the Cyprus Problem”, speech in the Pan-Cyprian Symposium of AKEL, *The Economic Aspects of a Federal Solution*, PIO, Nicosia, December 12, 1999, no. 3.

solution the gap between prices and wages would depend on the synergies between the two economies. The greater the economic interrelationship the smaller the gap between prices and wages and vice versa.

In those domains where competition would be inevitable, like tourism, economic forces would move in the direction of convergence.²¹ By the same token and as already noted, similar tendencies will prevail in all those sectors where competition will take place. Within this framework there may be a tendency toward price convergence in sectors like restaurants, shopping centres and so on.

Environment, Education, Health and Consumer Protection

In a two-state solution, these policies will be decided independently by the two authorities – despite the fact that there are certain areas where it may be mutually beneficial to pursue cooperative policies. This is particularly true for issues of environmental protection. There is also great room for cooperation in the areas of health and consumer protection.

Indeed under a unified Cyprus model, policies related to the environment, health and consumer protection would involve considerable cooperation and coordination. Even in the domain of education there could be room for addressing common challenges both in relation to meeting particular goals such as promotion of tolerance and understanding, and to continuously advancing standards.

It may be expected that in all four domains the Republic of Cyprus will be ahead due to the size of the economy as well as participation in the EU and the EMU. Turkish Cypriots may eventually be tempted to make comparisons.

An Overall Assessment

A two-state solution on the basis of the principle of “land for recognition” leads to interesting results. An important assumption of this model is that the EU and the international community will provide support for a compensation scheme as well as for Turkish Cypriots who will be relocated. Of course such policies will also require support and encouragement from the Republic of Cyprus.

This set of arrangements will initially lead to an economic boom. The Republic of Cyprus will benefit greatly from a huge wealth effect while the “TRNC” will reap the benefits of the legitimization process and will experience a smaller wealth effect.

If the two states exhibit willingness to cooperate then economic processes and new common interests will lead to the strengthening of relations on a voluntary basis. The limit of such cooperation is the possibility of seriously seeking ways for reunification although the political realities are such that this may be considered unlikely.

²¹ See M. Watson, “Growing Together? – Prospects for Economic Convergence and Reunification in Cyprus”, op. cit.; W. Noë and M. Watson, “Convergence and Reunification in Cyprus: Scope for a Virtuous Circle”, *ECFIN Country Focus*, op. cit.; M. Watson, and V. Herzberg, The Wolfson Cyprus Group Conference, “Sustainable Economic Development in Cyprus: Towards Economic Convergence and Reunification: The Case of the Northern Part of Cyprus”, *Macroeconomic and Financial Frameworks*, op. cit.

If the “TRNC” remains dependent on Turkey, gradually the gap between the two sides will widen in all aspects. This may lead to great difficulties, since if there are two fundamentally distinct socioeconomic and political systems with little communication and cooperation on the same island, it will be inevitable that comparisons will be made and particular perceptions of the ‘other’ will be reinforced.

A non-cooperative environment and a growing socioeconomic and political gap between the two sides will eventually lead ordinary citizens to make comparisons. Economic growth, availability of jobs, higher education and health standards, democratic institutions and the European currency as the national currency of the Republic of Cyprus, will sooner or later be an attractive set of arrangements for many Turkish Cypriots. Such a scenario could lead to increased pressure on the Turkish-Cypriot administration to seek cooperation with Greek Cypriots.

Whatever type of solution there is to the Cyprus problem there will be areas in which cooperation will lead to mutual benefits. Environmental concerns, for example, necessitate common approaches. And if there is concern about the best possible interests of consumers, Cypriots may be allowed to move freely throughout the island and also make their own decisions about buying goods and services. Such a scenario will have far-reaching economic, social and political implications.

Tourism will be of utmost importance for the whole island. It will not be an exaggeration to expect more than five million tourists annually on both sides. In relation to this particular sector it is expected that there will be competition between the two sides; this will be reflected both in prices and quality. We cannot rule out the possibility that business interests on both sides will form strategic alliances or at least find ways to cooperate with mutual gains.

It would be of great interest to evaluate how economic cooperation and the broader economic dynamics will influence the wider environment in the long run. Of course the influence and the strategic decisions of the EU and of Turkey on Cyprus will be of utmost importance.²²

²² Lack of cooperation on the part of Turkey will most likely lead to a further increase in the number of settlers, the continuation of the presence of the Turkish army, lack of coordination with the Republic of Cyprus on issues of concern to Cyprus and the EU, like illegal immigration and the environment. That is why within the framework of such a solution the EU and other interested parties should make sure that Turkey pursues a cooperative policy.

VI. SCENARIO D: FUNCTIONAL FEDERATION WITH LOOSE BIZONALITY

The Philosophical Positions and the Structure of a Functional Federation with Loose Bizonality

Functional federation with loose bizonality constitutes the author's model which incorporates the philosophy of the high level agreements of 1977 and 1979, the value system of the EU as well as a form of federalism which stresses more integration. It is based on the nine plus one (9+1) pillars discussed in earlier publications.¹ It should also be noted that it is a model which aspires to address current issues and challenges in an era of competition, openness and globalization. The 9+1 pillars of this model are the following:

Fundamental Guidelines of the Model²

- (1) *The Powers of the Central Government, the Hierarchy of Laws and Double Majorities*
The central government should have those powers that will allow it to function effectively. The laws of the federal state must have priority over the laws of the two regions except if the Supreme Court decides otherwise. Double majorities (and strong ones (2/3)) will apply only in the case of constitutional reforms. This provision on the one hand strengthens the functionality of the system and on the other hand ensures that no constitutional change can be made without a strong majority from both communities. In addition this sets the framework for a functional government and a process for change if need be and in a way in which no side feels threatened.

- (2) *The Territorial Issue*
The region under Turkish-Cypriot administration will comprise 27,5% of the territory. It is understood that the land that will be returned to the Greek-Cypriot side will include a greater percentage of coastline. All refugees will have *the right* to return. Even if all

¹ For more details see A. Theophanous, *European Cyprus: Constitutional Structure Economy and Society. Accession and Solution Scenaria* (in Greek), op. cit., especially pp. 203-217; A. Theophanous, *The Cyprus Question: The Challenge and the Promise*, op. cit., especially pp. 135-157; A. Theophanous, *Cyprus, the European Union and the Interests at Stake: EU Accession and the Solution* (in Greek), (Papazisis Press, Athens 2006), especially pp. 193-226.

² The thinking behind these guidelines was first put forward in A. Theophanous *European Cyprus: Constitutional Structure Economy and Society. Accession and Solution Scenaria* (in Greek), op. cit. With the discussion around the Annan Plan, I thought about the different aspects of potential scenaria much more. I put forward these ideas in a press conference on May 6, 2004, and I elaborated these ideas further in books and articles some of which are noted above in footnote 1.

Greek-Cypriot refugees do return there will still be a Turkish-Cypriot majority in the area under Turkish-Cypriot administration. This arrangement is important in that it allows for a Turkish-Cypriot majority in this particular region while simultaneously it allows the creation of social networks by Greek Cypriots. By the same token Turkish-Cypriot social networks may be created in the region under Greek-Cypriot administration. Obviously with this model a modest degree of integration is both encouraged and allowed.

(3) *Bicommunality and Bizonality and the Three Basic Freedoms*

Although bicommunality will be an inseparable part of the solution, it will not be an exclusive one. Bizonality will have a loose form and the provisions that will be made will not obstruct the three fundamental freedoms. For example, as mentioned previously all refugees would have the right to return. Furthermore, in effect there will only be limited restrictions to residency. However, for the Senate (or Upper House) citizens will vote with their community. This is essential to retain the 50-50 bicomunal arrangement at this level. It should be noted that with this constitutional arrangement the implementation of the three fundamental freedoms is facilitated.

(4) *The Settlers*

The issue of settlers must be addressed effectively. In addition, there will be provisions for the limitation of the number of Turkish citizens that might be able to enter and settle in Cyprus. In this regard it is essential to comprehend that this issue is seen as a security threat by Greek Cypriots. To address the problem effectively EU countries and especially the US may offer citizenship and/or residency to a number of settlers.

(5) *The Supreme Court*

The Supreme Court will consist of 4 Greek Cypriots, 4 Turkish Cypriots and 1 other member who will come from smaller communities on a rotation basis. The eldest judge will act as President of the Supreme Court. This arrangement is important in the sense that it gives legitimacy to the Republic of Cyprus and does not include foreign judges, whose presence would create the stigma of a protectorate. Furthermore, this provision gives greater incentives to the two communities for cooperation.

(6) *The Treaties of Guarantee and Alliance and the Cypriot Army*

The Treaty of Alliance and the Treaty of Guarantee will be abolished and all foreign troops will be withdrawn from the Republic of Cyprus. For a transitional period there will be provisions for peacekeeping troops within the framework of the UN and the EU. It is possible to have a professional army consisting of Greek Cypriots and Turkish Cypriots within the framework of the conventional obligations of the Republic of Cyprus toward the EU. This is important for several reasons. It gives the message that the Republic of Cyprus has matured and does not need patrons. After all the guarantor

powers were part of the problem and they cannot be part of a solution. In addition, the message that is given is that the Cypriot state is a 'normal' country without the presence of foreign powers.

(7) *The Republic of Cyprus Remains in Existence: The continuity of the Republic of Cyprus will be safeguarded by the solution*

The continuity of the Republic of Cyprus is of utmost importance for substantive, symbolic as well as practical reasons. The Republic of Cyprus as a member of the UN and the EU cannot dissolve itself and look forward to a new state entity. From a practical perspective already some Turkish Cypriots accept this position.³ The real challenge is for Turkish Cypriots to feel that they have a stake in the Republic of Cyprus and that after all it is their country/state too.

From a practical perspective it should be noted that it is easier to make readjustments to an existing state with an established functional economic, political, social and legal framework than to create a new state. Even if the two sides have the best intentions, a plan creating a new state would inevitably generate complications, legal gaps and contradictions.

Furthermore, it will not escape our attention that when the Republic of Cyprus was founded it lacked legitimization in the eyes of most Cypriots. It took time, effort, blood and tears to arrive at a point where it was fully accepted by all Greek Cypriots and where the majority of Turkish Cypriots *de facto* accept it as indicated by the use of documents of the Republic of Cyprus.⁴

(8) *The Efficiency of the Executive, Democracy and Popular Sovereignty*

The American system of President and Vice-President will be introduced with the additional provision that the President and the Vice-President will not come from the same community. In other words if a Greek-Cypriot runs for President, he/she must have a Turkish-Cypriot running mate and vice versa. All Cypriots will vote for the election of the President (and the Vice-President). The composition of the Council of Ministers will be on the basis of 70:30. The Upper House will be on the basis of 50:50 and the Lower House on the basis of 75:25. The provisions guarantee the federal structure of the system and at the same time encourage the spirit of cooperation.

(9) *The Importance of the Economy and of a Modern State*

The solution should advance the reestablishment of the integration and cohesiveness of the economy and of the society as well as the viability and effectiveness of the state.

³ The qualification though that they make is that they would not like to see the Republic of Cyprus as a Greek-Cypriot state.

⁴ It seems that there has been a serious underestimation of the risk of lack of legitimacy (or the existence of only a very limited degree of legitimacy) of a new state with a new flag.

All in all these arrangements encourage socioeconomic convergence and integration while at the same time they respect diversity.

(10) *Further Evolution*

If, in due time, developments are such that a functional federation evolves in which bizonality has less relevance, then, with the consent of the two sides, the bizonality provisions may be reassessed.

Implications of this Model

It is of utmost importance to understand that this model adopts an integrationalist approach.⁵ It respects both the individual/citizen as well as the community. Nevertheless, the power structure is such that the major role is reserved for the central government. In addition the envisioned constitutional structure encourages elites in both communities to pursue cooperative behaviour.

It is of utmost importance that the model also creates an integrated economy. This has far-reaching implications: on the one hand, the market mechanism will be allowed to operate without constitutional constraints and, on the other hand, the central government will assume a much greater role in the promotion of economic convergence.

It should also be noted that this model envisages a professional army that will carry out the obligations of the country towards the EU. This army will be composed of Greek Cypriots and Turkish Cypriots. It will be one of the many tests for the two communities to prove that they can work within the framework of unified institutions of a common country.

The Political Economy of a Functional Federation with Loose Bizonality⁶

Property Issue

This particular model, functional federation with loose bizonality, allows the implementation of the three fundamental freedoms of all citizens: the right to free movement, the right to settle and to acquire property throughout the island. This by itself also entails respect of the principle of restitution.⁷ Understandably the usurpation of Greek-Cypriot properties means that there will be some practical difficulties in applying the principle of restitution. Nevertheless, if we also take into consideration the market forces it may be possible to arrive at arrangements that may be mutually satisfactory under the circumstances.

⁵ For interesting reading see B. Rosamond, *Theories of European Integration*, (Palgrave, Basingstoke 2000) and G. Schneider and M. Aspinwall (Eds), *The Rules of Integration: Institutional Approaches to the Study of Europe*, (Manchester University Press, Manchester 2001). D. J. Elazar, *Exploring Federalism*, op. cit.

⁶ For a theoretical exposition in addition to references in footnote 1, see A. Drazen, *Political Economy in Macroeconomics*, op. cit., especially pp. 675-733.

⁷ This does not mean or imply that the principle should be put aside. On the contrary, the implication is that the owners of property should have the final say regarding the outcome. With a favourable political climate and with adequate economic incentives there can be solutions to this important but complicated issue.

It should also be noted that difficulties will exist with Greek-Cypriot properties in the area that will be under Turkish-Cypriot administration.⁸ It is expected that in many such cases there will be compensation or property exchanges. It will be much easier to deal with property issues in the areas that will be returned under Greek-Cypriot administration.

All in all those arrangements may take time but the most important element is that they are characterized by a process which leads to a legitimate outcome that may be acceptable.

Compensation

In this particular scenario in which restitution on the one hand and the market forces on the other have a dominant role, most cases will be dealt with accordingly. Consequently, the issue of compensation will arise in those cases in which particular properties have been already exploited/utilized. Given the primacy of the principle of restitution, arrangements for compensation will take into consideration the market value. This scenario entails complications for particular cases. Nevertheless even under this scenario the problems will be less than in alternative situations. Certainly international funds raised for compensation will help address particular cases.⁹

Three Fundamental Freedoms

The philosophy of this particular model – functional federation with loose bizonality – is integrationalist and allows for the application of the three fundamental freedoms. The question that is raised is whether the application and the implementation of the three fundamental freedoms may compromise bizonality. Given the distinction between strong and loose bizonality there will be only limited complications. The issue is that if indeed this model works and the forces of integration are stronger, then the model may, through an evolutionary process, change and adapt further and in a way that, in the long run, bizonality may become less relevant. What may be the relevant geographical unit then, may be the region, the town, the village, a particular zone and so on.¹⁰

Fiscal Policy

Within the framework of this model the fiscal policy of the central government will have a major role to play. As already noted loose bizonality allows the market forces to function with very limited constitutional restraints.¹¹ At the same time it becomes the responsibility of the central government to have a comprehensive economic policy which will aim at promoting internal economic convergence.

⁸ In this regard it should be noted that many Greek Cypriots would not want to live under Turkish-Cypriot administration.

⁹ The funds that were to be raised during the discussion of the Annan Plan would not have been adequate for compensation if that plan had been implemented. But with this particular model they would be adequate. This is because, in principle, all properties would be returned and in most other cases they would be dealt with by the parties involved utilizing the market mechanism.

¹⁰ For example, see J. D. Donahue, "Tiebout? Or Not Tiebout? The Market Metaphor and America's Devolution Debate", op. cit.; R. A. Musgrave, "Devolution, Grants, and Fiscal Competition", *The Journal of Economic Perspectives*, op. cit., would be an appropriate example. Furthermore see also A. Bourne, "Regional Europe", in M. Cini (Ed.), *European Union Politics*, op. cit.

¹¹ In other words, the stricter the bizonality clauses the greater the constitutional restraints and vice versa.

In addition, the central government will have the responsibility for meeting the relevant economic criteria which derive from participation in the EMU. It is reasonable to expect that following reunification the EU may allow Cyprus to have budget deficits greater than 3% for only a short period of time.¹²

On another note, the prospect of a unified country and the perception of a fair solution (in which everyone has the right to return, all elements of protectorate status such as guarantor powers are removed, and the presidential system allows for full political engagement) will make Greek Cypriots more willing to share the burden of economic convergence. Furthermore, the integrated economy will be associated with greater economic gains in the long run for all Cypriots. What is perhaps even more important, is that the expected dynamism of the integrated economy will, to a great extent, generate resources for economic convergence.

Legal Framework

As already noted this particular model – functional federation with loose bizonality – has a strong integrationalist perspective. Consequently, there will be many areas which will be covered by the same legal framework – European or national.

Given a unified economy as well as the participation of Cyprus in the EMU, the relevant legal framework will be unified in most financial and economic aspects. For example, rules and regulations dealing with the banking system, the insurance business and so on will inevitably be similar.

The domains over which issues may be addressed from different perspectives relate mostly to issues of the regions and the units of local self administration. Even those will have some common characteristics, given the common value system embedded in the constitution as well as emanating from participation in the EU. For example, waste disposal is subject to EU laws and regulations.

Decision-making Process

In contrast to the model of bizonal bicomunal federation in which the decision-making process is essentially based on double majorities, the model of functional federation with loose bizonality encourages approaches that do not necessarily depend on an exclusively communal basis. In this regard we should recall how the Executive is elected and how the Council of Ministers is formed. The Executive is popularly elected – the President from one community and the Vice-President from another but on the same ticket – and the Council of Ministries is representative of both communities. It is of utmost significance that the election of the President and the Vice-President as well as the formation of a government involve alliance building that runs across communities.

¹² This was noted and put forward by Professor Charles Wyplosz during a conference organized by the Ministry of Finance of the Republic of Cyprus, *Challenges inside the euro area: Life after 1/1/2008*, op. cit., as noted previously.

The fundamental element of the model is that it encourages the two communities to cooperate. This supports the expectation that the decision-making process will be effective. In many respects the system will be superior to the one provided by the Zurich agreements.

The Economics of Development

Economic convergence and balanced growth and development throughout Cyprus are major objectives. In turn their attainment will be of critical importance for the sustainability of the solution.

This particular model has greater chances of successfully promoting economic convergence as well as balanced growth and development. This is because the central government will be playing a more important role while at the same time, unlike the strict bizonality model, the market mechanism will have only limited constitutional constraints. The policy of the central government will entail a comprehensive strategy which inevitably will include transfer of resources to the northern part of Cyprus (e.g. through a development tax).¹³ Greek Cypriots will be inclined to accept such a transfer because the model is an integrationist one. Moreover, government policies will be more effective due to the more effective operation of the market mechanism.

A determined government strategy in conjunction with the free market can create the best possible conditions for particular and well-targeted EU programmes to be effective. By the same token, an environment characterized by integration and cohesiveness will be much more favourable for European and international investors.

Social Security Fund and Related Policies

The philosophy of the functional federation with loose bizonality model encourages integration and cohesion. While it respects and cherishes the particular and distinct cultural characteristics of the two communities, in the sphere of economics the central government has a major role to play. This role includes managing and administering the Social Security Fund and the related social policies such as unemployment benefits, help for disabled persons and so on.

In the very short run there will be discrepancies in relation to benefits and terms of engagement between Greek Cypriots and Turkish Cypriots. But the objective in the long run is to achieve convergence in this domain as well. It is noted that this is the only model which

¹³ The transfer of resources to the northern part of Cyprus on the day after a solution could be undertaken in several ways. The important element is that it should be done in a way in which it has the support of the public. Note H. Brey's observation in relation to the reunification of Germany: H. Brey, "The German Experience of Reunification and Useful Lessons for Cyprus", in A. Theophanous and Y. Tirkides (Eds), *Accession to the Eurozone and the Reunification of the Cyprus Economy*, op. cit., pp. 143-179, but especially see p. 176, and in particular point 3.

addresses these issues comprehensively. In the other models the relevant policies do not fall within the competencies of the central government.¹⁴

Competition

Within the framework of a unified economy in which the market system is allowed to operate, the forces of competition will be enhanced with multidimensional benefits for all Cypriots in terms of economic growth and opportunities.

It should be noted that currently one of the problems in the government-controlled areas is the tremendous increase in the value of land. That has made the ownership of houses and apartments for young couples and persons in general much more difficult. A unified economy will *de facto* entail a major increase in the supply of land in the area under Greek-Cypriot administration.¹⁵ Inevitably there will be a relative decrease in the prices of land or at least the rate of growth of prices will be decelerated.

In relation to the prices of land in the northern part of Cyprus there will be two effects: (a) on the one hand a legitimization process and (b) an increase of prices to catch up with the rest of the island. This will be of great importance for Turkish Cypriots.

It would be interesting to engage in a sectoral analysis of the day after a unified economy and integrated markets. All in all it will not be a surprise to see a new economic miracle, the miracle of reunification.

Local Administration

Under functional federation with loose bizonality, local administration will acquire particular importance. This is because the central government will be rather strong while the regional governments will not be endowed with functions and jurisdiction that will give them a major role. A federal philosophy with loose bizonality will allow the integration of people irrespective of ethnic, religious or linguistic background. In this context the role of local administration will be considerably enhanced.¹⁶ This tendency will also be further strengthened by the fact that the EU pays particular attention to local administration.¹⁷

Settlers

One of the major pillars of this model is that the issue of settlers is considered a political one although other aspects of it are also acknowledged.¹⁸ Consequently, within the framework

¹⁴ In the other scenario the Social Security Fund and related policies are under the jurisdiction of the two regional governments. Note that in the case of Belgium there have been ideas about the creation of two separate funds!

¹⁵ This will be an outcome of the return of land as well as of the overall legitimization process.

¹⁶ In essence this will be an outcome of a redistribution of power from the regional governments to the units of local administration. Such changes and redistribution of power are a common phenomenon within the framework of federalism. It is also noted that redistribution of power can take place in several forms such as from the centre to the regions or vice versa.

¹⁷ For interesting reading see M. Keating, *New Regionalism in Western Europe*, (Edward Elgar, Cheltenham 2000).

¹⁸ Greek Cypriots consider it a security issue. See Greek-Cypriot proposals, "Outline Proposals for the Establishment of a Federal Republic and for the Solution of the Cyprus Problem", (January 30, 1989), op. cit., and compare with M. Hatay, *Beyond Numbers: Inquiring into the Political Integration of "Turkish Settlers" in Northern Cyprus*, op. cit.

of a solution a substantial number of settlers will be repatriated. As already noted EU countries and especially the US can help to overcome this thorny issue by offering residency or citizenship to a number of settlers. Those who will stay will acquire resident status and their children will also be citizens of the Republic of Cyprus. Within this particular model there will be a permanent derogation for people from Turkey to enter and reside in Cyprus without procedures. Indeed this issue will be a major function of the central government and not of the two regional administrations.

Immigration

The domain of immigration is of special importance for all countries of the EU. In the case of Cyprus this acquires additional importance due to the Cyprus conflict and also because Cyprus is the south-eastern frontier of the EU and as a result citizens of neighbouring countries have a natural tendency to move to Cyprus (or via Cyprus to another EU country) for socioeconomic as well as for political reasons.

Immigration will be exclusively one of the functions of the central government. For the successful implementation of a well-structured immigration policy Cyprus will require the support of the EU at different levels.¹⁹

Foreign Workers

Cyprus is already an attractive destination for foreign workers. In this respect it should be noted that Cyprus will attract workers from other members of the EU as well as from third countries. Within the framework of a comprehensive economic and immigration policy the central government should monitor the flow of foreign workers from third countries. As already noted Cyprus is an attractive destination for socioeconomic and political reasons. Consequently, in order to prevent social and other problems, this issue must be addressed effectively and comprehensively. The two regional administrations will not have the authority to give permission to foreign workers from third countries to enter Cyprus. Given that Cyprus is a relatively small country there would be legitimate reasons to have an upper limit even for workers from other European countries.

Tourism

Within the framework of an integrated economy tourism will receive a major boost and inevitably will become an enhanced engine of long-term growth. It would be reasonable to expect that, following a solution, Cyprus can ultimately expect to receive more than five million tourists annually.

¹⁹ Cyprus is expected to join the Schengen zone at the end of 2008. It is also important that Cyprus also seeks support from Brussels for the implementation of the relevant provisions.

One should not underestimate the networks of cooperation between Greek-Cypriot and Turkish-Cypriot interests that indeed may involve substantial benefits. This may include a particularly growing number of tourists both from Greece and Turkey who will be rediscovering Cyprus. Furthermore, particular business groups will explore possibilities for including Cyprus in regional comprehensive plans.

Furthermore, it is essential to note that the new business setting will involve a change of relative prices and an immense growth of domestic tourism. Relative prices in the Greek-Cypriot administered areas will tend to decrease or stabilize while the opposite will be the case in the Turkish-Cypriot administered areas. Inevitably this will lead to a convergence of relative prices.

All in all, given the particular importance of this sector, it is expected that the whole economy of the country will be positively affected. Indeed, tourism may prove to be one of the engines of growth after the solution, and in such ways that Cyprus would experience a new economic miracle.²⁰

Labour Market

With the reunification of Cyprus along the lines of this particular integrationist model, it is expected that there will be sustained economic expansion. This will be generated by the process of reconstruction, the process of harmonization with the *acquis communautaire*, by European targeted plans and programmes as well as by international investment. Under these circumstances not only will conditions of full employment prevail but also we cannot preclude the possibility of acute labour shortages.

The increase in demand for labour will have the tendency to increase wages. At the same time, however, there will be another process leading to a convergence of salaries throughout the island and their alignment with productivity.

Prices

Within the framework of reunification via an integrationist model there will be several forces at work which will dynamically affect prices. At a general level an enlarged market entails greater competition; thus, there will be a tendency for a reduction in price levels. Furthermore, there will be a dynamic process which will lead to convergence of prices throughout the island. In general this may mean a stabilization or a reduction of prices in the areas under Greek-Cypriot administration and an increase of prices in the areas under Turkish-Cypriot administration. In relation to the latter development, it is noted that this process had already started in the period after April 23, 2003.

²⁰ G. Vassiliou had made this point in 1992 while he was campaigning for reunification on the basis of the Ghali Set of Ideas. See G. Vassiliou, "Prospects for a federal solution of the Cyprus Problem", speech in the Pan-Cyprian Symposium of AKEL, *The Economic Aspects of a Federal Solution*, PIO, op. cit.

It would be of particular importance to address the issue of prices after reunification on a sectoral level. Suffice it to note that this particular integrationalist model will lead to more competition and to sustained economic expansion. If issues are managed in an efficient manner the economic results will be very beneficial for consumers and for the economy as a whole.²¹

Environment, Education, Health and Consumer Protection

Within the framework of this integrationalist model the central government will have a major role over environmental issues. Of course the support of the regional administration and of the general public is essential but, given also the obligation emanating from participation in the EU, it will be necessary to have a national environmental policy.

Before 2003 there was less environmental damage to the northern part of Cyprus.²² Since then there have been excesses in that part of the island as well. A comprehensive environmental policy will be of utmost importance. Toward this end the central government will have a major role but at the same time the cooperation of regional administrations will be essential.

Primary and secondary education will be a domain over which the two regional administrations will have greater jurisdiction than the central government.²³ In relation to tertiary education both levels of government will have their own responsibilities. A major issue that must be addressed is whether or how the central government will finance/subsidize education in the two administrative regions.

Health will be mostly the responsibility of the two regions. Nevertheless the central government will work toward upgrading standards and also achieving convergence in the quality of service. It is also envisaged that the central government may have a policy to which all medical providers/units in the country must adhere. Furthermore, the central government may have a system through which some form of financial support is offered to the two regions.

Consumer protection is also a domain over which both levels of government will have a role to play. On the one hand, competition in the market place will be to the interest of consumers; on the other hand, the implementation of the relevant *acquis* will constitute an additional safety valve. It is of utmost importance that there is cooperation between the two communities at all possible levels especially in relation to issues like consumer protection.

²¹ The idea is that lower relative and absolute prices would also enhance the competitiveness of the economy of Cyprus.

²² See P. Hocknell, "Contested 'Development': a Retrospective of the UN Development Programme in Cyprus", in O. P. Richmond and J. Ker-Lindsay (Eds), *The Work of the UN in Cyprus* (Palgrave, Basingstone/New York 2001), pp. 157-192.

²³ The central government may help financially and also provide some general guiding principles. But the overall functions will be a communal affair. I use the word communal in view of the fact that with loose bizonality there will be mixing of the population and, therefore, communal issues will be raised in addition to the regional dimension.

An Overall Assessment

There is no doubt that this integrationalist model – functional federation and loose bizonality – offers the best possible economic outcomes. Loose bizonality allows for the implementation of the three fundamental freedoms and also the integration of the population.

The net impact with developments in relation to the property issue will generate a huge wealth effect. This will be one of the reasons for the economic boom which is expected to take place. Reconstruction as well as the effort for harmonization with the *acquis communautaire* in the northern part of Cyprus will also be of great importance. Not only will conditions of full employment be created but it is also expected that there will be job vacancies that will be filled by non-Cypriot workers.

A fundamental objective of the central government will be economic convergence in all aspects. This is a major goal and its implementation will greatly contribute to the sustainability of the settlement. Nevertheless this will take time.

It will be of utmost importance that the population exhibits patience, maturity and a spirit of cooperation. More specifically Turkish Cypriots should understand that economic convergence will not occur overnight. And it will also be important that they should be equally aware about their obligations. Greek Cypriots will have to understand that they should contribute to the objective of economic convergence. If this objective is achieved it will be a strong stabilizing factor.

This integrationalist model advances the objective of reaching decisions for the implementation of particular goals. In essence, while this particular model respects bicommunality, it also goes beyond bicommunalism. These particular objectives are set within the framework of comprehensive modern perspectives and goals, such as economic convergence, balanced growth and development, fulfilling the criteria for successful participation in the EMU and so on.

This particular model encourages both elites as well as the citizens to think and act beyond bicommunalism. If successfully implemented the outcome would be an impressive economic record. There are two issues though that need to be addressed in relation to this: (a) would, in the first place, the Turkish side consent to such a framework? (b) what are the prerequisites for such a constructive engagement by the two communities?²⁴

²⁴ Obviously the issues raised constitute an important domain for further research.

VII. CONCLUDING REMARKS, POLICY RECOMMENDATIONS AND SUGGESTIONS FOR FURTHER RESEARCH

In this final chapter we put forward the major conclusions in relation to the political economy of each of the four scenaria examined in this study. Within this framework a comparative analysis is also undertaken in relation to these models and scenaria. At the same time it is considered important to address, albeit briefly, the political realities and the circumstances and prerequisites under which a particular scenario may be advanced. Last but not least, recommendations are put forward and also suggestions are made for further research.

A Comprehensive Evaluation of the Four Scenaria

Bizonal Bicommunal Federation

The analysis suggests that the model that has been discussed more often and has been viewed as mainstream – bizonal bicommunal federation – even if implemented, will have serious problems of viability. It should be clarified that in this case bizonal bicommunal federation is defined within the framework of the philosophy of the Annan Plan. Enhanced bizonality is a major characteristic of this model leading to two zones, each with a strong ethnic element. Given also strong bicommunality and a strong form of consociationalism, decisions will be essentially reached by dual majorities.

Assuming that the decision-making process does not create any particular problems, the strong or even the enhanced bizonality will tend to create economic bottlenecks and problems. It will be difficult to practically have labour and capital mobility and to also implement the right to acquire property throughout the island. This would most likely impede the process of economic convergence of the two regions.

Cyprus may also face fiscal problems given the three-headed state embedded in the model; this will entail three budgets and occasionally potentially conflicting fiscal policies. It would be important to have coordination as well as the political will to meet the obligations which emanate from participation in the EMU. Philosophically this model would make it difficult for the central government to function smoothly as the centre of gravity; instead, it would be the two component/constituent states that will perform this role. Problems may also arise and be exacerbated if the socioeconomic gaps between the two component/

constituent states are enhanced. Greek-Cypriot tax payers will be more willing to endure sacrifices if there is a vision of a common country. In the absence of an integrationalist perspective, it will be very difficult to contain discontent.

Stalemate/Continuation of the Status Quo

The continuation of the *status quo* entails severe losses, foregone opportunities and a much more difficult political environment. It is understood that with the *status quo* the “TRNC” will seek to upgrade itself economically and politically. The usurpation of Greek-Cypriot properties will continue while at the same time Turkish Cypriots will continue to enjoy rights as citizens of the Republic of Cyprus without any obligations.

Inevitably this will bring about the resentment of Greek Cypriots. Already this has been taking place to some limited extent. This has been exhibited in several ways including an overall decreasing number of crossings by Greek Cypriots to the northern part of the country.¹

The upgrading of the standard of living of Turkish Cypriots and their gradual reintegration with the rest of the world will also decrease the possibility for a breakthrough. And this despite the belief that such development will facilitate the solution. Indeed, the question raised is what incentives would the Turkish Cypriots have for concessions if they have almost all they want free and without obligations?

The stalemate is also associated with much waste and foregone opportunities. Particular attention is paid in this regard to the case of the deserted city of Famagusta. It was more than once reported that part of the deserted city would be given back to the Greek Cypriots as a gesture of good will and as a confidence building measure. But nothing has materialized so far.²

Two-State Solution

As already outlined, this scenario is based on the principle of “land for recognition”; the assumption made is that following this arrangement the Republic of Cyprus will have 72,5% of the territory and the “TRNC” 27,5%. It has been noted that the guarantee system envisaged in 1960 will be abolished and that the British Bases will be renegotiated as they would not be sovereign any more. It would be up to the Republic of Cyprus to see whether they will continue to function within a new legal framework.

This solution will generate an economic boom in the Republic of Cyprus as an outcome of a huge wealth effect – return of land, exchanges and compensation for those that will not receive their properties back. Although the Turkish side will give back some territory, there

¹ Crossings on both sides have decreased after 2005 (see Appendix D). Furthermore, the Greek Cypriots openly express the view that Turkish Cypriots have the “best of two worlds” without any obligations.

² The Turkish-Cypriot leader Mehmet Ali Talat as well as Turkish officials have repeatedly expressed the view that the return of the fenced city of Famagusta would be part of a comprehensive solution. It should be stressed though that the issue of Famagusta had been discussed as a possible confidence building measure as early as the seventies.

will be a wealth effect in the Turkish side also, though of lower intensity. The positive impact will be due to the legitimization process and the payment of compensations. The legitimization process will be associated with a wealth effect because it will encourage a normalization of economic life including the improvement of the allocation of resources. Land prices will also rise in the “TRNC”.

To the extent that the two states embark on a path of cooperation and the “TRNC” on a process of modernization and Europeanization there will be added mutual benefits. Furthermore, it may also be possible, at least in theory, to create the prerequisites for reunification in the future.³ Synergies may exist in various sectors. There can be both cooperation and competition in relation to tourism where the prospects could be very promising. Within a philosophy of cooperation citizens can be allowed to travel freely and thereby make their purchases accordingly. Cooperation could also include the labour market, health, education, environment, illegal immigration and so on. Such a process will be beneficial for both sides.

If on the other hand the “TRNC” remains under the strong influence of Turkey, and the socioeconomic gap with the Republic of Cyprus grows even more, one should not rule out some form of antagonism and cold relations. A negative scenario may include the lack of cooperation in the areas of illegal immigration. Furthermore, with cold relations the freedom of movement throughout the island may be subject to restrictions. Obviously this is not a desirable outcome.

Functional Federation with Loose Bizonality

This particular model has its own philosophy which does not coincide with the one embedded in the Annan Plan. On the other hand, it should be noted that this particular model could also be seen as not contradicting the high level agreements of 1977 and 1979. On the contrary, it could be stressed that it is within the philosophy of the high level agreements. In addition, the model incorporates fundamental principles from the European political culture and acknowledges the implications of the participation of a country in the EU and the EMU. The fundamental element of this model is that it encourages the two communities to cooperate. This supports the expectation that the decision-making process will be effective.

It may be tempting to raise the question of the relationship of this particular model with the high level agreements and the philosophy of the Annan Plan (and how they could be related). In this regard it should be stressed that the Annan Plan, which included provisions for strong bizonality, reflected to a great extent the philosophy of the Turkish side. The suggested model, on the other hand, incorporates part of the original interpretation of the high level agreements.⁴

³ For this scenario to materialize the strong involvement of the EU and the US would be necessary as well as the cooperation of Turkey.

⁴ A. Theophanous, “Which bizonal bicomunal federation?” (in Greek), *Politis* newspaper, op. cit.

Functional federation with loose bizonality encourages integration and acknowledges the particular characteristics of the two communities as well as their needs.⁵ At the same time the model incorporates the particularities/realities of participation in the EMU and of a globalized world.

Undoubtedly, this is the model which generates the best possible socioeconomic results. It advances economic integration with the contribution of the central government and support from the EU within a climate which stresses the free market forces. It is also the only model discussed where the Social Security Fund and related policies function under the central government.

It is also the model which would generate the best possible conditions for sustained economic expansion. This in itself will create the circumstances for dynamically addressing the challenge of internal and external economic convergence. If such a model is implemented it will not be an exaggeration to expect a new economic miracle.

Evidently the model is quite ambitious. Perhaps it is the only one which guarantees a unified Cyprus. For years, politicians from both sides, especially from the Greek-Cypriot community, referred to a solution that would require “painful concessions”. Voters did not follow because they realized that not only were the concessions embedded painful, but also the particular model/solution would not be stable.⁶ There was fear that worse developments would have ensued.⁷ This particular model could be addressed in a way in which the parties involved may see it as a fair and desirable arrangement.

The Political Realities and the Four Scenarios

From our analysis it is clear that functional federation with loose bizonality provides the best possible model to achieve reunification, socioeconomic convergence and also the prerequisites for political stability. Such a model could also contribute to the implementation and promotion of broader interests. Indeed a successful model of functional federation in Cyprus and the constructive cooperation of Greek-Cypriot Christians and Turkish-Cypriot Moslems will be of great importance to the broader region.⁸

The question that is raised, however, is whether, at this particular stage, this model can be accepted by Ankara and the Turkish-Cypriot leadership. This model leads to the effective participation of Turkish Cypriots in all aspects of public life and to a process of economic

⁵ The point made is that this particular model, although based on the philosophy of integration, also includes provisions for communal and local self administration.

⁶ This view was expressed not only by moderate supporters of the NO campaign but also by several independent observers. (From interviews with several foreign diplomats and foreign nationals residing in Cyprus).

⁷ This was one of the views expressed by the then President Papadopoulos on April 7, 2004 in his historic address to the Greek Cypriots. See PIO: http://www.moi.gov.cy/moi/pio/pio.nsf/index_gr/index_gr?OpenDocument

⁸ A. Theophanous, *The Cyprus Question: The Challenge and the Promise*, op. cit. pp. 168-196; see also A. Theophanous, “Euro-Turkish Relations and Cyprus” in N. Goren and A. Nachmani (Eds), *The Importance of Being European: Turkey, the EU and the Middle East*, op. cit., pp. 32-50.

convergence. In principle these objectives are shared by Turkish Cypriots. Ankara and the Turkish-Cypriot leadership may object, however, to the political framework through which these objectives are met, namely through an integrationalist federal model and the continuity of the Republic of Cyprus.

On the other hand, the philosophy adopted and cherished by the Turkish side cannot lead to a viable outcome even if accepted by Greek Cypriots. We should recall that the Turkish side insists on strict bizonality, strict bicomunalism and political equality (with a particular definition). These pillars lead to a model with characteristics of federation and confederation. Such a model revolves around the philosophy of the Annan Plan. Its implementation will most likely lead to two almost homogenous regions and a central government where, essentially, dual majorities will be required for decisions. In this model power will not emanate from the central government, but instead from the two regional governments. There will be tensions due to the lack of a common vision, lack of adequate coordination and sustained socioeconomic gaps between the two sides. At best this model may collapse and lead to a velvet divorce.⁹ Under such circumstances the relations between these two sides will be cold.

On the other hand, assuming that a two-state solution is agreed based on the principle of “return of land for recognition” there is a good possibility that the two sides may embark on a process of cooperation. This cooperation may lead to even revisiting the issue of reunification.¹⁰ For such a course of action it is essential that Ankara accepts these ideas and also that the “TRNC” independently embarks on a process of modernization and Europeanization. Is this possible? If it is, as already noted, the cooperation between the two sides will lead to mutually beneficial outcomes. If not, the antagonism between the two sides as well as a climate of cold relations could lead to tensions.

Be that as it may, this scenario is rather unlikely: it is doubtful whether the Turkish side would consent to the return of a substantial portion of territory and that Turkey would accept the idea of two completely independent states; it is also unlikely that Britain would accept this form of solution by which the Bases change legal status. Besides, it would, most likely, be very difficult for a Greek-Cypriot leader to sign such a solution.¹¹

We have seen why it may be difficult for any of the three models – bizonal bicomunal federation, functional federation with loose bizonality and a two-state solution – to be accepted and implemented, given the current political realities. By the process of elimination it seems that the most probable outcome in the immediate short run is the continuation of

⁹ For a very interesting article see J. Muller, “The Clash of Peoples – US and Them: The Enduring Power of Ethnic Nationalism”, *Foreign Affairs*, vol. 87, (2008), no. 2, (March-April), pp. 18-35. See also A. Theophanous, “What model can lead Cyprus to a promising future?”, *Cyprus Mail*, March 16, 2008, p. 18.

¹⁰ It is interesting to note that in 1993 a veteran politician T. Evdokas stated in an interview that division was a more pragmatic approach which could at a particular stage lead to reunification. T. Evdokas, Interview in the (then) Greek-Cypriot daily *O Agon*, October 10, 1993.

¹¹ From interviews with several politicians.

the stalemate. Even if this is the case it would be of utmost importance to manage it. Confidence building measures and discussion of the advantages and disadvantages of particular scenarios is of utmost importance. This will pave the way for a final settlement.

The Way Forward and Suggestions for Further Research

While there has been some progress in 2008 it will be difficult to overcome a structural deadlock in the Cyprus problem. It is essential to understand the dynamics embedded in, and the need for, a new approach. The pursuit of conventional orthodoxy – that of bizonal, bicommunal federation – cannot be expected to provide a functional arrangement. As this study has sought to demonstrate if it is implemented it will lead to political frictions and deadlocks which will be persistent and regenerated by socioeconomic difficulties. Moreover, such a model will have serious problems of political legitimacy worse than those of the London-Zurich arrangements.

A two-state solution as an outcome of an agreement based on the principle “land for recognition” may not be feasible for two fundamental reasons: on the one hand, the Turkish side may not be prepared to return adequate land to Greek Cypriots and also to accept a sovereign Greek state in Cyprus and on the other hand, Britain is not likely to accept the termination of the sovereign status of the British Bases. In addition, even if these two issues were overcome, it may be difficult to find a Greek-Cypriot leader to sign it. Even if an agreement on this basis was found, however, and if the two states do not embark on a cooperative path there will be tensions.

If the current stalemate continues, despite renewed efforts, and with the political deadlock deepening, eventually the two sides may enter an antagonistic period. Even if the elites of both sides within the perspective of political correctness try to maintain a normal climate, Greek Cypriots will have increased frustrations which will come out; they will not be satisfied with conditions leading to the normalization of the *status quo* which entails usurpation of their properties in the northern part and with Turkish Cypriots having rights in the Republic of Cyprus and no obligations.

It is obvious that something must change to move forward. Functional federation with loose bizonality as defined in this study may offer a serious pragmatic option.

It is acknowledged, nevertheless, that it may be difficult to implement such an integrationalist model immediately.¹² But if there is an understanding that the solution to the Cyprus problem should safeguard the unity and the territorial integrity of the Republic of Cyprus, respect the rights of all Cypriots and of the two communities, and also depend on the philosophy of integration, then there can be a way forward.

¹² The opening of the Ledra Street on April 3, 2008 is a major step in the right direction. But it is essential that it is followed by more steps and progress in relation to the resolution of the Cyprus problem.

The adoption of Confidence Building Measures and the utilization of EU processes can be of utmost importance. In this regard the return of Famagusta to its lawful inhabitants, the utilization of the port of the city for both communities, the beginning of a process of harmonization in relation to a number of chapters of the European *acquis communautaire* in the northern part of Cyprus can lead to a new climate on the island.

The longer the stalemate persists the more difficult it becomes for the two sides to reach an agreement. Furthermore, there is the risk of the two sides getting involved in an antagonistic relationship which may reverse even the existing levels of cooperation between the two sides.

Last but not least, it is essential to understand and evaluate different aspects of the relationships between the two communities. In this regard it is vital to assess the socioeconomic implications of the new realities in Cyprus in the post April 23, 2003 period. In addition, it may be particularly important to assess what the elites as well as the ordinary people on both sides understand by the concept of federalism.

It is also of utmost importance to enhance policy oriented research on both sides as well as outside the island given that the Cyprus question is a complex one involving several dimensions. Within this framework it is essential to evaluate the dynamics of the post April 23, 2003 situation and assess the results. To the extent that there have been positive results, the challenge is to see what policy package can enhance them. By the same token, it is of utmost importance to evaluate the negative aspects of the record and see whether and how it can be reversed.

Another important chapter that should be addressed is the impact of a solution beyond Cyprus; it is essential to analyze the effects of a solution which, on the one hand, proves viable and generates cooperation and prosperity and, on the other hand, collapses. The hypothesis embedded in this issue is whether indeed developments on the island have an impact beyond Cyprus. If there is an impact then we must analyze the possible repercussions and how the course of events can be influenced in particular directions.

Last but not least, there must be an enhanced dialogue between Greek Cypriots and Turkish Cypriots on all issues and at all levels.¹³ Even if there are disagreements and different perceptions it will be better if they come to the surface. At the end of the day, if Greek Cypriots and Turkish Cypriots are destined to share power and economic prosperity they must learn to debate, agree, disagree and also find ways to overcome disagreements and misperceptions.¹⁴ Equally important is to learn to create synthesis from different starting points.

¹³ Undoubtedly the intercommunal dialogue is essential at all levels. At the same time it is also important to have a dialogue, even informally, between mainland Turks and Greek Cypriots. Indeed, the latter also constitutes a suggestion of the ICG Report in Cyprus on 2008. "Cyprus: Reversing the Drift to Partition", Europe Report No. 190, *International Crisis Group*, op. cit., p.p. ii, 10, 11, 26.

¹⁴ A necessary prerequisite for such a development is the end of foreign interventions in the Republic of Cyprus and the respect of the territorial integrity, sovereignty and independence of this state.

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APPENDIX A

High-Level Agreement of February 12, 1977 between Makarios and Denktash

The text of the agreement between the then Greek-Cypriot leader and President of the Republic of Cyprus, Archbishop Makarios, and the Turkish-Cypriot leader, Mr Rauf Denktash, concluded on February 12, 1977, during a meeting under the auspices of the United Nations Secretary-General Dr Kurt Waldheim, is the following:

- 1. We are seeking an independent, non-aligned, bi-communal Federal Republic.*
- 2. The territory under the administration of each community should be discussed in the light of economic viability or productivity and land ownership.*
- 3. Questions of principles like freedom of movement, freedom of settlement, the right of property and other specific matters, are open for discussion, taking into consideration the fundamental basis of a bi-communal federal system and certain practical difficulties which may arise for the Turkish-Cypriot community.*
- 4. The powers and functions of the central federal government will be such as to safeguard the unity of the country having regard to the bi-communal character of the State.*

APPENDIX B

High-Level Agreement of May 19, 1979 between Kyprianou and Denktash

The text of the agreement between the then Greek-Cypriot leader and President of the Republic of Cyprus, Mr Spyros Kyprianou, and the Turkish-Cypriot leader, Mr Rauf Denktash, concluded on May 19, 1979, during a meeting under the auspices of the U.N. Secretary-General, Dr Kurt Waldheim, is the following:

- 1. It was agreed to resume the intercommunal talks on 15 June 1979.*
- 2. The basis for the talks will be the Makarios-Denktash guidelines of 12 February 1977 and the U.N. resolutions relevant to the Cyprus question.*
- 3. There should be respect for human rights and fundamental freedoms of all citizens of the Republic.*
- 4. The talks will deal with all territorial and constitutional aspects.*
- 5. Priority will be given to reaching agreement of the resettlement of Varosha under U.N. auspices simultaneously with the beginning of the consideration by the interlocutors of the constitutional and territorial aspects of a comprehensive settlement. After agreement on Varosha has been reached it will be implemented without awaiting the outcome of the discussion on other aspects of the Cyprus problem.*
- 6. It was agreed to abstain from any action which might jeopardize the outcome of the talks, and special importance will be given to initial practical measures by both sides to promote goodwill, mutual confidence and the return to normal conditions.*
- 7. The demilitarization of the Republic of Cyprus is envisaged, and matters relating thereto will be discussed.*
- 8. The independence, sovereignty, territorial integrity and non-alignment of the Republic should be adequately guaranteed against union in whole or in part with any other country and against any form of partition or secession.*
- 9. The intercommunal talks will be carried out in a continuing and sustained manner, avoiding any delay.*
- 10. The intercommunal talks will take place in Nicosia.*

APPENDIX C

Proposal for a Lasting Solution in Cyprus by the Leader of the Turkish-Cypriot Community Rauf Denktaş, August 31, 1998

As a final effort to achieve a mutually acceptable lasting solution in Cyprus, I propose the establishment of the Cyprus Confederation based on the following arrangements:

- 1. A special relationship between Turkey and TRNC on the basis of agreements to be concluded.*
- 2. A similar special relationship between Greece and the Greek Cypriot Administration on the basis of symmetrical agreements to be concluded.*
- 3. Establishment of a Cyprus Confederation between TRNC and GCA.*
- 4. The 1960 Guarantee System shall continue.*
- 5. The Cyprus Confederation may, if parties jointly agree, pursue a policy of accession to the EU. Until Turkey's full membership of the EU, a special arrangement will provide Turkey with the full rights and obligations of an EU member with regard to the Cyprus Confederation.*

The ultimate aim of the negotiations will thus be a partnership settlement which will be a confederated structure composed of two peoples and of two states of the island supported by symmetrical agreements with the two respective Motherlands and Guarantor States. All rights and powers which are not referred to the confederal entity will reside with the two confederal states. Any agreement to be reached as a result of the negotiations will be submitted for approval in separate referenda.

By participating in these negotiations the parties will acknowledge that the Greek and Turkish Cypriot sides are two sovereign and equal states, each with its own functioning democratic institutions and jurisdiction, reflecting the political equality and will of their respective peoples. They will also acknowledge that the authorities of one party do not represent the other.

We believe that only this structure

- (a) will provide for the security of both sides,*
- (b) will safeguard their identity and well-being.*

If the Greek Cypriots agree to this final basis, we are ready to begin negotiations to establish the Cyprus Confederation.

APPENDIX D

Crossings on both sides of the Green Line 2003-2007

Crossings of Greek Cypriots and Turkish Cypriots and Vehicles from both sides of the UN Buffer Zone

Table 1: Crossings of Greek Cypriots and Turkish Cypriots and Vehicles in 2003

| MONTH | CROSSINGS OF PERSONS | | | CROSSINGS OF VEHICLES | | |
|----------------|----------------------|------------------|------------------|-----------------------|----------------|----------------|
| | G/C | T/C | TOTAL | Vehicles G/C | Vehicles T/C | TOTAL |
| 04 / 2003 | 133.530 | 33.356 | 166.886 | 21.740 | 0 | 21.740 |
| 05 / 2003 | 224.067 | 152.387 | 376.454 | 54.519 | 8.960 | 63.479 |
| 06 / 2003 | 127.902 | 145.428 | 273.330 | 34.207 | 13.573 | 47.780 |
| 07 / 2003 | 125.481 | 160.181 | 285.662 | 33.037 | 16.944 | 49.981 |
| 08 / 2003 | 184.760 | 173.232 | 357.992 | 47.629 | 27.162 | 74.791 |
| 09 / 2003 | 91.313 | 198.696 | 290.009 | 27.505 | 36.654 | 64.159 |
| 10 / 2003 | 99.136 | 176.146 | 275.282 | 27.477 | 35.765 | 63.242 |
| 11 / 2003 | 70.896 | 171.068 | 241.964 | 22.570 | 34.928 | 57.498 |
| 12 / 2003 | 66.635 | 160.605 | 227.240 | 22.381 | 38.943 | 61.324 |
| TOTAL | 1.123.720 | 1.371.099 | 2.494.819 | 291.065 | 212.929 | 503.994 |
| AVERAGE | 124.858 | 152.344 | 277.202 | 32.341 | 23.659 | 55.999 |

Source: Ministry of Justice and Public Order, Republic of Cyprus

Table 2: Crossings of Greek Cypriots and Turkish Cypriots and Vehicles in 2004

| MONTH | CROSSINGS OF PERSONS | | | CROSSINGS OF VEHICLES | | |
|----------------|----------------------|------------------|------------------|-----------------------|----------------|----------------|
| | G/C | T/C | TOTAL | Vehicles G/C | Vehicles T/C | TOTAL |
| 01 / 2004 | 76.233 | 151.151 | 227.384 | 25.410 | 38.522 | 63.932 |
| 02 / 2004 | 77.369 | 191.922 | 269.291 | 26.596 | 43.227 | 69.823 |
| 03 / 2004 | 93.076 | 186.605 | 279.681 | 31.958 | 42.693 | 74.651 |
| 04 / 2004 | 97.706 | 163.574 | 261.280 | 31.179 | 37.767 | 68.946 |
| 05 / 2004 | 90.387 | 181.259 | 271.646 | 31.759 | 41.305 | 73.064 |
| 06 / 2004 | 96.116 | 183.284 | 279.400 | 33.962 | 42.782 | 76.744 |
| 07 / 2004 | 102.677 | 183.678 | 286.355 | 35.770 | 40.966 | 76.736 |
| 08 / 2004 | 148.930 | 162.461 | 311.391 | 48.496 | 39.425 | 87.921 |
| 09 / 2004 | 98.020 | 191.379 | 289.399 | 34.826 | 46.229 | 81.055 |
| 10 / 2004 | 107.166 | 190.984 | 298.150 | 38.646 | 45.890 | 84.536 |
| 11 / 2004 | 87.833 | 179.157 | 266.990 | 32.294 | 44.328 | 76.622 |
| 12 / 2004 | 98.312 | 194.087 | 292.399 | 34.458 | 50.101 | 84.559 |
| TOTAL | 1.173.825 | 2.159.541 | 3.333.366 | 405.354 | 513.235 | 918.589 |
| AVERAGE | 97.819 | 179.962 | 277.781 | 33.780 | 42.770 | 76.549 |

Source: Ministry of Justice and Public Order, Republic of Cyprus

Table 3: Crossings of Greek Cypriots and Turkish Cypriots and Vehicles in 2005

| MONTH | CROSSINGS OF PERSONS | | | CROSSINGS OF VEHICLES | | |
|----------------|----------------------|------------------|------------------|-----------------------|----------------|------------------|
| | G/C | T/C | TOTAL | Vehicles G/C | Vehicles T/C | TOTAL |
| 01 / 2005 | 98.988 | 161.512 | 260.500 | 34.798 | 40.405 | 75.203 |
| 02 / 2005 | 79.149 | 172.200 | 251.349 | 28.048 | 39.125 | 67.173 |
| 03 / 2005 | 106.077 | 183.385 | 289.462 | 38.673 | 50.223 | 88.896 |
| 04 / 2005 | 131.545 | 177.552 | 309.097 | 40.575 | 45.473 | 86.048 |
| 05 / 2005 | 135.681 | 194.819 | 330.500 | 42.909 | 43.767 | 86.676 |
| 06 / 2005 | 120.236 | 196.713 | 316.949 | 40.810 | 44.740 | 85.550 |
| 07 / 2005 | 115.975 | 200.774 | 316.749 | 39.632 | 45.360 | 84.992 |
| 08 / 2005 | 129.825 | 160.500 | 290.325 | 43.241 | 41.784 | 85.025 |
| 09 / 2005 | 111.552 | 191.461 | 303.013 | 37.666 | 48.103 | 85.769 |
| 10 / 2005 | 112.026 | 181.608 | 293.634 | 38.221 | 48.287 | 86.508 |
| 11 / 2005 | 89.886 | 187.488 | 277.374 | 31.161 | 52.648 | 83.809 |
| 12 / 2005 | 88.959 | 214.187 | 303.146 | 32.964 | 64.241 | 97.205 |
| TOTAL | 1.319.899 | 2.222.199 | 3.542.098 | 448.698 | 564.156 | 1.012.854 |
| AVERAGE | 109.992 | 185.183 | 295.175 | 37.392 | 47.013 | 84.405 |

Source: Ministry of Justice and Public Order, Republic of Cyprus

Table 4: Crossings of Greek Cypriots and Turkish Cypriots and Vehicles in 2006

| MONTH | CROSSINGS OF PERSONS | | | CROSSINGS OF VEHICLES | | |
|----------------|----------------------|------------------|------------------|-----------------------|----------------|----------------|
| | G/C | T/C | TOTAL | Vehicles G/C | Vehicles T/C | TOTAL |
| 01 / 2006 | 69.902 | 192.822 | 262.724 | 26.398 | 57.235 | 83.633 |
| 02 / 2006 | 45.184 | 150.087 | 195.271 | 19.059 | 51.661 | 70.720 |
| 03 / 2006 | 77.273 | 157.077 | 234.350 | 26.949 | 56.576 | 83.525 |
| 04 / 2006 | 99.095 | 152.279 | 251.374 | 32.838 | 51.988 | 84.826 |
| 05 / 2006 | 88.945 | 166.285 | 255.230 | 31.266 | 57.114 | 88.380 |
| 06 / 2006 | 94.965 | 153.747 | 248.712 | 33.665 | 54.996 | 88.661 |
| 07 / 2006 | 96.478 | 154.126 | 250.604 | 34.219 | 53.453 | 87.672 |
| 08 / 2006 | 110.284 | 139.202 | 249.486 | 36.588 | 52.104 | 88.692 |
| 09 / 2006 | 60.986 | 98.676 | 159.662 | 25.427 | 49.020 | 74.447 |
| 10 / 2006 | 56.755 | 100.720 | 157.475 | 26.793 | 50.477 | 77.270 |
| 11 / 2006 | 49.483 | 87.754 | 137.237 | 22.220 | 46.142 | 68.362 |
| 12 / 2006 | 47.694 | 85.959 | 133.653 | 17.053 | 33.652 | 50.705 |
| TOTAL | 897.044 | 1.638.734 | 2.535.778 | 332.475 | 614.418 | 946.893 |
| AVERAGE | 74.754 | 136.561 | 211.315 | 27.706 | 51.202 | 78.908 |

Source: Ministry of Justice and Public Order, Republic of Cyprus

Table 5: Crossings of Greek Cypriots and Turkish Cypriots and Vehicles in 2007

| MONTH | CROSSINGS OF PERSONS | | | CROSSINGS OF VEHICLES | | |
|----------------|----------------------|------------------|------------------|-----------------------|----------------|------------------|
| | G/C | T/C | TOTAL | Vehicles G/C | Vehicles T/C | TOTAL |
| 01 / 2007 | 43.670 | 89.064 | 132.734 | 18.465 | 38.663 | 57.128 |
| 02 / 2007 | 36.729 | 89.786 | 126.515 | 16.660 | 43.796 | 60.456 |
| 03 / 2007 | 46.417 | 98.177 | 144.594 | 22.434 | 53.145 | 75.579 |
| 04 / 2007 | 56.417 | 84.719 | 141.136 | 27.133 | 47.191 | 74.324 |
| 05 / 2007 | 60.721 | 90.980 | 151.701 | 60.962 | 63.049 | 124.011 |
| 06 / 2007 | 53.333 | 94.802 | 148.135 | 43.846 | 51.508 | 95.354 |
| 07 / 2007 | 51.265 | 92.799 | 144.064 | 55.790 | 59.192 | 114.982 |
| 08 / 2007 | 64.967 | 84.913 | 149.880 | 56.678 | 58.577 | 115.255 |
| 09 / 2007 | 52.682 | 96.161 | 148.843 | 50.985 | 65.184 | 116.169 |
| 10 / 2007 | 47.621 | 103.276 | 150.897 | 46.110 | 66.848 | 112.958 |
| 11 / 2007 | 40.834 | 90.814 | 131.648 | 22.902 | 42.052 | 64.954 |
| 12 / 2007 | 46.695 | 101.499 | 148.194 | 21.856 | 40.795 | 62.651 |
| TOTAL | 601.351 | 1.116.990 | 1.718.341 | 443.821 | 630.000 | 1.073.821 |
| AVERAGE | 50.113 | 93.083 | 143.195 | 36.985 | 52.500 | 89.485 |

Source: Ministry of Justice and Public Order, Republic of Cyprus



The Political Economy of a Cyprus Settlement: The Examination of Four Scenaria

Conventional orthodoxy in relation to a possible solution of the Cyprus problem has revolved in the last forty years around the concept of a bizonal, bicomunal federation. The two communities, however, have different interpretations of the concept. On top of that within each community there exist various perspectives.

This study focuses on four scenaria: (a) bizonal bicomunal federation, (b) stalemate/continuation of the status quo, (c) two-state solution, and (d) functional federation with loose bizonality. Each scenario leads to a unique set of arrangements and outcomes.

It has been argued that if bi-ethnic and multi-ethnic societies are based exclusively on ethno-nationalist pillars it would be difficult, if not impossible, to sustain peace, cooperation, security and prosperity. From an economic perspective the author notes that a bi-ethnic and/or multi-ethnic state founded on ethnonationalism is likely to lack the appropriate economic structure and necessary economic dynamics to make it viable. Furthermore, it does not create the circumstances which lead to a comprehensive, cohesive and coordinated economic policy that is essential in promoting socioeconomic convergence. In addition, strong bizonality will not lead to an integrated economy and society.

According to the study, a functional federation with loose bizonality generates a preferred outcome. This model adopts an integrationalist federal philosophy and encourages cooperation and the emergence of common objectives. It also considers that socioeconomic convergence will be the outcome of several factors: certainly the central government will have to play a significant role and so will the special programmes and projects of the EU. However, the most important role will be played by market forces.

The model takes into serious consideration the objectives of the two ethnic communities; consequently, this model too is characterized by bi-communalism, although it attempts to go beyond it. Furthermore, it distinguishes between strict and loose bizonality and adopts the position that with the implementation of the latter, and in conjunction with the other characteristics of the model, it is possible to promote an integrated society, strong institutions and a viable and dynamic economy.

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