

ECONOMY AND FINANCE

SOCIO-ECONOMIC AND POLITICAL IMPACT OF AUSTERITY POLICIES IN NORTH CYPRUS

A Brief Assessment

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2020



This report evaluates the impact of austerity policies on Turkish Cypriot economy, society and politics by using official statistics and interviews with experts.



The results of the austerity measures have been mixed. The budget deficit has been reduced but public debt stock is still high; moreover, household debt has considerably increased.



Falling living standards and external meddling created a backlash on the political parties across the political spectrum and made governing more difficult.

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Executive Summary

Unlike in many other countries where austerity measures were implemented in the same period, in north Cyprus, austerity measures were not introduced to address the adverse yet temporary effects of the Great Recession on public finances. But rather these policies were devised to overhaul the politico-economic structure of a small, de facto state, which has been isolated from the rest of the world for half a century and dependent on financial assistance from Turkey. The change in attitude of Ankara towards the Cyprus problem, with the coming to power of the Justice and Development Party (AKP) in Turkey in 2002, also led to a change in economic policy towards the northern part of Cyprus. Ankara has become more reluctant to finance what it sees as the profligacy of Turkish Cypriot politicians. Hence the belt-tightening.

The most obvious problem of the Turkish Cypriot economy has been the huge share of personnel and transfer expenditures in the public budget, which stem from decades of clientelistic expansion of the public sector. Accordingly, one of the key targets of the austerity policies was reducing the attractiveness of the public-sector jobs. There were three main policy instruments: (1) reducing the entry level salaries of public sector employees; (2) freezing all salaries, pensions and social security payments in real terms for a year in 2011; and, (3) reforming the pension system.

The results of the austerity policies have been mixed. Public-sector employees, pensioners and recipients of social security benefits all saw their real incomes decline. As a result, the budget deficit has been reduced. However, public debt stock as a share of GDP is still too high. Furthermore, as people who did not want to change their consumption patterns chose to borrow to make up for loss in their real incomes, household debt increased too.

Meanwhile, the economy seemed to be growing but has failed to generate white collar jobs that would satisfy young university graduates. By 2017, the GNP in dollar terms was below its 2008 level. Although the entry level salaries in the public sector have been reduced in real terms, as the working conditions in the private sector have not been improved, the public-sector jobs remain to be 'the greatest object of desire' for most Turkish Cypriot employees.

Financial dependence on Turkey has steadily decreased in the period concerned. This can be seen as good news in the context of inter-communal negotiations between the Turkish Cypriot and Greek Cypriot sides because a viable economic system in the northern part of Cyprus may help to change the negative perception in the south that Turkish Cypriots would constitute a burden on the federal state. On the downside, in the meantime, a considerable amount of debt has been accumulated by the TRNC as borrowing from Turkey continued.

Although financial dependence on Turkey has subsided, there is no sign of decline in Turkey's political influence. On the political front, austerity measures created a backlash on the governing parties across the political spectrum and made governing more difficult. The last three general elections were all called earlier than scheduled while turnout steadily decreased, a manifestation of growing political discontent among Turkish Cypriot voters. As no end is in sight for austerity policies, this trend is likely to continue putting more strain on the political system.

INTRODUCTION

The Turkish Republic of Northern Cyprus (TRNC)¹ is a de facto state, which is recognised only by Turkey. The unilateral declaration of independence, which came in 1983, can be seen as the culmination of efforts to form a separate Turkish state in Cyprus, which had practically started in 1964 with the formation of the General Committee following the forceful withdrawal of Turkish Cypriots from government institutions of the Republic of Cyprus (see Sonan 2014, p. 60), where they were partners in a consociational setup. With a per capita GNP of US\$14,000 in 2017, the TRNC is the most prosperous de facto state, if Taiwan is put aside. It uses Turkish lira as legal tender and relies both politically and financially on Turkey to maintain its survival while inter-communal negotiations between the two communities to reunify the island under a bi-communal, bi-zonal federal state continue on and off.

As the economic and social indicators in Table 1 show, since 2002, the TRNC has been going through a major transformation both economically and politically. By voting overwhelmingly for the United Nations' reunification plan in 2004, the Turkish Cypriot community has gained the sympathy of the international community by showing that it is ready to come to a compromise settlement with the Greek Cypriot community in the framework of a bi-communal, bi-zonal federation, as stated in the United Nations parameters. In other words, by accepting the so-called Annan plan, the Turkish Cypriot side, for the first time, expressed its willingness to give up its quest for a separate Turkish Cypriot state on the island. Accordingly, the European Union, which admitted the whole island in 2004, adopted a more positive attitude towards Turkish Cypriots. This was outlined by the General Affairs Council of the EU on 26 April 2004 as follows:

The Turkish Cypriot community have expressed their clear desire for a future within the European Union. The Council is determined to put an end to the isolation of

the Turkish Cypriot community and to facilitate the reunification of Cyprus by encouraging the economic development of the Turkish Cypriot community. The Council invited the Commission to bring forward comprehensive proposals to this end with particular emphasis on the economic integration of the island and on improving contact between the two communities and with the EU (European Commission Representation in Cyprus 2019).

In line with this statement, the EU allocated €259 million in 2006 for a five-year programme, followed by annual allocations of €30 million from 2011 on (*ibid.*). Although this was only a fraction of what Turkey used to transfer annually and can be seen as a small consolation for the missed opportunity of joining the EU, it is nevertheless a symbolic political achievement.

In terms of economic growth, this was a spectacular period because in the six-year period between 2002 and 2008, per capita GNP almost quadrupled. This was achieved largely thanks to the increase in flows of funds from Turkey and foreign demand for holiday homes in the northern part of the island, where prices were much lower compared to the southern part. In this period, the Turkish loans and grants grew from US\$282 million to US\$583 million and then peaked in 2009 with US\$600 million (Kendirci et al. 2018, p. 186). The construction sector grew by 187% between 2002 and 2007 (Devlet Planlama Örgütü 2017). This construction boom took place largely because the provisions of the failed Annan plan for the property issue have partly alleviated the uncertainty about the status of Greek Cypriot properties left behind after 1974 and encouraged buying and selling of pre-1974 Greek Cypriot-owned land. Thanks to this and an increase in financial flows from Turkey, the Turkish Cypriot economy recorded double digit growth between 2003 and 2007 with an average annual growth of 13% (Kalkınma ve Ekonomik İşbirliği (KEİ) 2009, p. 13).

This unprecedented boom in the Turkish Cypriot economy was followed by a bust. The decline coincided with the global recession. However, in many respects, the Turkish Cypriots' austerity saga is different from other cases because, although the TRNC experienced negative growth for two consecutive years in 2008 (-3,4%) and 2009 (-5,7%) as did the rest of the world, its banks did not experience any major problems. It

¹ While for Turkey and the Turkish Cypriots, Mustafa Akıncı serves as President of the TRNC, the international community considers him the communal leader of the Turkish Cypriots. As the government of the Republic of Cyprus remains internationally recognised as the government of the whole of the island, the entire island is now considered to be a member of the European Union. However, the *acquis communautaire* is suspended in northern Cyprus pending a political settlement to the Cyprus problem (see Protocol no. 10 of the Accession Treaty).

Table 1
Main economic and social indicators about the TRNC: 2002–2017

	2002	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
GNP (Million \$)	941,4	3.598,8	3.995,6	3.502,5	3.750,6	3.908,5	3.840,8	3.969,5	4.031,9	3.744,7	3.839,3	3.984
GNP per capita (\$)	4.409	14.765	16.158	13.930	14.703	15.403	15.038	15.302	15.109	13.721	13.902	14.187
Real growth rate (%)	6,9	1,5	-3,4	-5,7	3,6	4,0	0,5	1,3	4,9	4,1	3,8	5,5
Inflation	24,5	9,4	14,5	5,7	3,3	14,7	3,6	10,2	6,5	7,8	10,2	14,7
Unemployment (%)	na	9,40	9,80	12,40	11,90	9,50	8,70	8,40	8,30	7,40	6,40	5,80
Employed	na	89.787	91.223	91.550	93.498	97.103	96.539	97.867	103.149	112.815	118.388	120.999
Foreigners employed with a work permit	na	na	na	na	29.976	29.819	31.155	31.222	33.313	35.197	39.436	44.121
Population	213.491	268.011	274.436	283.736	286.973	283.281	292.129	301.988	313.626	326.158	335.455	345.722
Exports	45,4	83,7	83,7	71,1	96,2	152,9	122,4	120,7	133,9	118,1	105,5	105,6
Imports	309,6	1.539,2	1.680,7	1.326,2	1.604,2	1.699,9	1.705,3	1.699,4	1.784,3	1.500,6	1.554,9	1.778,40
Net tourism revenues (Million \$)	114,1	381,0	383,7	390,7	405,8	459,4	571,9	613,4	679,0	698,0	739,4	865
Net higher education revenues (Million \$)	na	589,8	636,2	694,8	765,9							
Foreign students enrolled in Turkish Cypriot universities	17611	33135	36324	32075	28564	41401	46134	55057	63422	72241	80874	87607
Health expenditure / GNP (%)	2,8	3,9	3,5	3,5	3,4	3,1	3,1	3,2	3,1	2,5	2,8	na
Health expenditure / Budget (%)	5,0	8,6	7,6	7,4	7,3	7,2	7,3	7,4	7,6	6,6	7,7	na
Number of beds in public hospitals	922	1.022	971	1.015	1.026	1.028	1.007	1.007	1.007	1.007	1.007	na
Number of specialist doctors in public hospitals	172	205	212	218	231	228	223	226	224	228	212	na
Number of nurses in public hospitals	399	650	663	680	665	664	680	692	694	731	740	na

Source: Devlet Planlama Örgütü (2017 and 2018a) and Kendirici (2018).

has not faced the risk of a sovereign default either, because it did not borrow from international financial institutions because of its isolation from the international financial market and institutions. As Besim and Mullen (2009, p. 95) put it, 'Simple balance sheet structures, sourced from domestic deposits, together with traditional banking services, mean that there has been no direct impact of the global financial crisis on the "TRNC" banking sector'.

Rather, the attempt to restructure its economy can be seen as a result of a policy change adopted by the Turkish government, which has been bankrolling the Turkish Cypriot quest for statehood for decades. As the Turkish Cypriot Minister of Finance of the time, Ahmet Uzun, said in an interview a few years later, 'The old Turkey was no longer there', and in this period the Turkish Cypriot governments received a different kind of i.e. less generous treatment from their Turkish counterparts (Tümerkan 2012).

Against this backdrop, this report aims to make a brief evaluation of the impact of austerity measures on Turkish Cypriot economy, society and politics. It does so by (1) using mainly the official figures provided by the Turkish Cypriot State Planning Organisation (*Devlet Planlama Örgütü*) and the Office of Economic Development and Cooperation – the Turkish agency, under the Turkish Embassy in Nicosia (*T.C. Lefkoşa Büyükelçiliği Kalkınma ve Ekonomik İşbirliği Ofisi (KEİ)*), responsible for implementing and monitoring the economic programmes agreed by the Turkish Cypriot and Turkish governments; and (2) conducting interviews with a number of experts and practitioners.

The report starts with an historical overview of the Turkish Cypriot community's relationship with the state as an employer to give an idea about why austerity and public sector reform receive so little support from political parties from either the right or left. The section also shows the role of Turkey in the expansion of the public sector.

THE HISTORICAL FACTORS BEHIND THE BIG PUBLIC SECTOR IN NORTH CYPRUS

As in other cases where austerity measures are implemented, in the Turkish Cypriot case too, they were not welcome by the people. If we are to make a sound analysis of the resistance against reform in the public sector at both the elite and mass levels, we must put in its historical context the relationship between the state, as an employer, and an average Turkish Cypriot, as an employee. Navaro-Yashin vividly stated in an anthropological perspective:

Turkish-Cypriots strongly desire to be appointed as state officers. Parents exploit their social networks to arrange such positions for their children. Families of brides-to-be search for civil servant grooms. Despite the fact that stories are recounted about the laxity of civil servants and the inefficacy of the 'state', such positions and the people who retain or obtain them are highly prized (Navaro-Yashin 2006, p. 281).

This has become, in a way, part of Turkish Cypriot culture, and the reasons behind it should be sought in its history and politics. Historically, Turkish Cypriots formed the backbone of public administration and were disproportionately represented in government institutions both in Ottoman and British periods. According to Attalides, 'The traditional ruling class position of the Muslims as administrators and landowners did not encourage economic enterprise which was left in the hands of the *Rayas*' (1977, p. 87). This did not change in the British period. In 1901, in the police force, for instance, 'there were 281 Muslims and 387 Christians,' at a time when Muslims, i.e. Turkish Cypriots, constituted around a quarter of the island's population (*ibid.*). By 1963, when the Turkish Cypriots constituted 18,2% of the population (while Greek Cypriots formed 77,1%), the Turkish Cypriot contribution to the Gross National Product (in value added terms) in public administration and defence was 27,2% (versus Greek Cypriots' 68,3%) (Panagides 1968, p. 138). The Turkish Cypriot contribution in agriculture, manufacturing and services on the other hand, were 12,1%, 6,1% and 15% respectively (*ibid.*)

The period between 1964 and 1974, when Turkish Cypriots lived in ghettos/enclaves largely away from economic activities, not only further distorted this structure but also played a crucial and formative role on the politico-economic landscape of the post-1974 period: 'present state administration in Northern Cyprus [was] established in the enclaves [...]. The

political and economic dependence on Turkey, the unrecognised status, the civil-military complex, as well as the tendency for "big government" were all established in that period' (Navaro-Yashin 2006, p. 288).

The three-headed administration, which was made up of the Turkish Cypriot civilian leadership, the Turkish commander of the Turkish Resistance Organisation (*Türk Mukavemet Teşkilatı*, TMT) and the Turkish Ambassador forced people to leave their villages and livelihoods and resettle in the nearest enclave. To quote Navaro-Yashin once again, people were told, 'Leave your job, settle in the enclave, join the resistance, here is flour, here is a salary for you'. Following the geographical division of the island in 1974, the same approach was adopted: 'Here is civil service for you, here is a salary' (Navaro-Yashin 2006, p. 287).

The government jobs were distributed to accrue legitimacy for the politico-economic structure formed after 1974. This is to say, the politico-economic structure of the north in this period cannot be understood independent from the Cyprus conflict. Until the December elections of 2003, the Turkish Cypriot community had been governed by governments dominated by two right-wing parties: National Unity Party (*Ulusal Birlik Partisi*, UBP), which formed every government from 1976 to 2003 (except for a 36-month hiatus between 1994 and 1996) either on its own or as the senior coalition partner, and its splinter Democratic Party (*Demokrat Party*, DP), which formed the first non-UBP government in 1994. Both of these parties are in favour of maintaining the status quo in the island, i.e., they are essentially against reunification under a federal settlement. As their stance was in line with the Turkish military-civilian establishment, they were favoured by Ankara and were seen as a bulwark against the pro-reunification left dominated by the Republican Turkish Party (*Cumhuriyetçi Türk Partisi*, CTP) and the Communal Liberation Party (*Toplumcu Kurtuluş Partisi*, TKP). This state of affairs paved the way for a politico-economic structure characterised by what Lyrintzis calls 'bureaucratic clientelism', which basically

consists of systematic infiltration of the state machine by the party devotees and the allocation of favours through it. It is characterized by an organised expansion of existing posts and departments in the public sector and the addition of new ones in an attempt to secure power and

maintain a party's electoral base. ... In a system such as this the public bureaucracy is orientated less towards the effective performance of public service than towards provision of parasitic jobs for the political clientele of the ruling sectors, in exchange for their political support (1984, p. 103).

In every election period, the public sector expanded further. This was bankrolled by Ankara for a very long time, although from time to time, belt-tightening policies were imposed by reform-minded Turkish politicians, such as Turgut Özal who imposed the first austerity programme in 1986. Indeed, since the 1960s, the Turkish government has been footing the bill for the Turkish Cypriot efforts to consolidate a separate Turkish Cypriot political entity in Cyprus. The General Committee and its successor, Autonomous Turkish Cypriot Administration, which acted as the de facto government of the Turkish Cypriot community from the onset of the civil war in December 1963 until July 1974 – when the geographical division took place following a Greek orchestrated coup d'état and the Turkish military intervention – received 90% of its budget from Turkey (Sonan 2014, p. 81). The picture did not change much after 1974. From 1974 to 2004 around US\$3 billion was transferred from Turkey to the TRNC (Sonan 2007, p. 9), whereas the amount transferred between 2002 and 2017 reached US\$6,47 billion, of which US\$2,96 billion was in grants (Kendirici et al. 2018, p. 194). It should be noted that until 1997, all Turkish financial transfers were recorded only as grants/donations. Since then, the Turkish funds transferred to the TRNC have been made up of both grants/donations and loans. Essentially, transfers to plug the budgetary deficit are loans while infrastructure investments and defence spending are recorded as grants. So far, no repayment has been made to Turkey.

AFTER SUNSHINE COMES THE RAIN: AUSTERITY MEASURES

Starting the discussion on austerity with a definition of austerity would be apt. Mark Blyth defines it as

a form of voluntary deflation in which the economy adjusts through the reduction of wages, prices, and public spending to restore competitiveness, which is (supposedly) best achieved by cutting the state's budget, debts, and deficits. Doing so, its advocates believe, will inspire 'business confidence' since the government will neither be 'crowding-out' the market for investment by sucking up all the available capital through the issuance of debt, nor adding to the nation's already 'too big' debt (Blyth, 2013, p. 2).

With some caveats, the main justification brought about for austerity policies in the case of north Cyprus was parallel to Blyth's definition of austerity. It is worth adding that austerity is also defined as a means to 'tame welfare-state capitalism' (see Plehwe et al. 2019, p. v). This is not a valid definition for the particular case of north Cyprus because, what makes the public budget so big is not services a typical welfare state would provide to its citizens but rather bureaucratic clientelism.

In the absence of ties with the rest of the global economy, austerity in the Turkish Cypriot context came as a demand from the Turkish government. Since 1986, the two sides have many times agreed to cut down the size of the public sector in the northern part of Cyprus and introduced austerity measures. However, for reasons having to do with the Cyprus conflict and political instability in Turkey, which led to frequent changes in government, these efforts have been intermittent. Only towards the end of the first decade of the 2000s, the Turkish government started to stand adamant about the implementation. This had something to do with the developments regarding the Cyprus problem as well as changes in Turkish domestic politics. Justice and Development Party's (*Adalet ve Kalkınma Partisi*, AKP) relatively flexible stance regarding the settlement of the Cyprus problem and its endorsement of the Annan plan paved the way for normalisation of Turkish Cypriot politics as well. This is to say, as AKP was not willing to sustain the status quo in Cyprus, it was not bound to support the clientelistic policies of the nationalist parties to ensure their electoral success. As a result of this and the wider political context, i.e. the prospect of joining the EU, a pro-reunification party, CTP, became the senior

coalition partner for the first time following the 2003 December general elections.

Against this backdrop, in 2006, the Turkish and Turkish Cypriot governments signed a protocol where for the first time, the amount of financial transfers from Ankara was determined in advance and made subject to conditions. Reportedly, this was demanded by the Turkish Cypriot side (see Münir 2010). The protocol constituted the basis for the three-year programme (2007-2009) entitled 'Reform and Support Programme for Sustainable Development' [*Sürdürülebilir Kalkınma İçin Yapılandırma ve Destek Programı*]. The programme was made up of three sections: (1) restructuring of the public sector; (2) strengthening of the real sector; and, (3) restructuring of the financial sector (KEİ 2009).

The pension system was one of the first targets of austerity policies. As part of the clientelistic policies implemented in the 1980s, the pension system was very generous to the public sector employees. For those who had been appointed to the public administration by the Public Service Commission (*Kamu Hizmeti Komisyonu*) before April 1985, it was possible to retire after only 10 years of service, while those who were appointed between April 1985 and July 1987 had to work for 15 years. In both cases, there was no minimum age requirement (Okandan, n.d.). Those who were appointed after July 1987 were required to work for 25 years. Once this period was completed, the employee was entitled to receive her retirement bonus regardless of her age but had to wait until the age of 56 to be entitled to receive her pension (*ibid.*).

It was also possible to receive a generous retirement bonus, which was calculated by multiplying the last gross salary by the number of years in service. The retirement system was in effect another incentive making the public-sector employment more attractive. The most important step to change this was the 73/2007 Social Security Law, which entered into force on 1 January 2008. From 2008 on, everyone working in the private or public sector has become subject to the same conditions. The retirement age has become 60 (and 25 years of contribution to the social security fund). Furthermore, the retirement bonus in the public sector has been abolished for those who joined the public service after 2007. These changes were passed without much public resistance.

Other requirements of the protocol, such as a ceiling for the budget deficit of the TRNC, necessitated more ambitious reforms. One of the most important and controversial elements of the austerity measures was the Law Regulating the Monthly Salary, Wage and Other Allowances of the Public Employees, 47/2010 [*Kamu Çalışanlarının Aylık Maaş – Ücret ve Diğer Ödeneklerinin Düzenlenmesi Yasası*], which would substantially decrease the entry level salaries and other material benefits of the new public sector employees. Passing this was a real challenge for the CTP-ÖRP (*Özgürlük ve Reform Partisi*, Freedom and Reform Party) coalition government, which was already feeling the adverse effects of recession in 2007 and 2008. Eventually, under pressure from Ankara, the government accepted to submit this bill to parliament and in return secured funding from Turkey for the payment of 13th salaries (13th month payment). Yet, calculating for the backlash, which would be inevitable, the government also called a snap election before passing it in parliament (Tümerkan 2013).

The trade unions called the bill *Göç Yasası* (the emigration law) because they argued that ‘by substantially reducing the entry-level salaries in the public sector, it will impoverish the youth joining the labour force and in doing so lead to mass emigration’ (Ioannou and Sonan 2014, p. 8). First reaction came from 22 unions, which called a general strike on 18 February 2009 (Kıbrıs Türk Öğretmenler Sendikası (KTÖS) 2014, p. 4).

The main opposition party, UBP, made resistance to the bill the backbone of its electoral campaign. In the run up to the 19 April 2009 snap election, in a letter dated 11 February 2009 and addressed to the two biggest trade unions organised in the public sector, Kamu-Sen and KTAMS, Derviş Eroğlu, the UBP leader, explicitly promised that should his party come to power, it, inter alia, ‘would vote against the bill at both committee and plenary level’; ‘that the cost of living adjustment (COLA), which is applied every two months will continue’ and that they would not tax retirement bonuses (cited in Erhürman 2011).

Thanks to these promises, the UBP won the election by a landslide (see Sözen and Sonan 2019). However, Eroğlu could not keep his promise. A few months after coming to power, in July, the UBP government issued a decree and changed the application of COLA from two to six months. The government also introduced restrictions on overtime payments. In an address to the people Eroğlu put the blame of these policies on the previous government’s profligacy and reiterated his government’s intention not to tax pensions and retirement bonuses (see *Star Kıbrıs* 2009). Moreover, the Minister of Finance, Ersin Tatar declared that ‘Turkey is our IMF ... the era of asking from Turkey, taking, and distributing has come to an end’ (*Hürriyet* 2009).

Trade unions, which strongly reacted to these changes (for more on this see, for instance, *Hürriyet* 2009 and KTÖS 2014), also mobilised their members to deter the government from passing the bill regulating salaries of new public sector employees. On 14 September 2009, for instance, Trade Unions

Platform, which was made up of some 30 unions visited the Turkish Embassy and handed a letter addressed to the Turkish Prime Minister Recep Tayyip Erdoğan. Furthermore, on 28 October 2009 they called a general strike and held a demonstration. Protestors clashed with the police, which had blocked the road in front of the parliament (and Turkish Embassy) where the demonstration would take place; the police detained 19 of the protestors and eventually took eight of them to court. The Trade Union Platform also held a mass demonstration in front of parliament when it was in session to discuss the bill. During the demonstration, for the first time in Turkish Cypriot history, the police used tear gas to dispel demonstrators and detained 16 of the protestors (Sayarı 2009). The bill was eventually passed on 23 November 2009.

In line with Article 146 of the TRNC Constitution, the then president Mehmet Ali Talat referred the approved bill to the Constitutional Court for its opinion as to whether it was constitutional or not. The Constitutional Court found certain articles in violation of the constitution. Derviş Eroğlu, who in the meantime had become the new president defeating Talat, returned the bill back to the assembly. After amendments, the law was approved in October 2010 and came into force on 1 January 2011 (KTÖS 2014, p. 3). The most striking provision of the legislation was reducing the entry level salaries of university degree holders and high-school graduates by almost 33%.²

The main basis of the criticism the trade unions posed against this law was the Universal Declaration of Human Rights’ Article 23, which stipulates that ‘everyone, without any discrimination, has the right to equal pay for equal work’, because introduction of this law meant a civil servant appointed in 2011 would receive a considerably lower salary than her colleagues appointed a year earlier even though they both do exactly the same thing. Eventually, the unions took it to the Constitutional Court, but the Court ruled that the law did not violate the constitution.

The Turkish government became much less lenient in the 2010-2012 programme, which aimed ‘to increase the public [sector]’s efficiency and the private sector’s competitiveness’ (KEİ 2009). The programme’s main target was identified as ‘decreasing the share of the public sector in the economy’ and ‘creating a competitive economy driven by private sector’ (KEİ 2009, p. 5). This involved decreasing budget deficits and minimizing government borrowing while increasing revenue and rationalizing expenditures (KEİ 2009, p. 16). As a result, Eroğlu’s successor as the Prime Minister and UBP leader, İrsen Küçük, reneged on his predecessor’s promise not to tax pensions and introduced a tax on pensions above TL 3.000 (*Milliyet* 2010); this move was eventually struck down by the Constitutional Court, but dented credibility in the Prime Minister and his party.

Another significant measure taken by the UBP government,

² Calculated by the authors based on salary scales provided by Kıbrıs Türk Öğretmenler Sendikası (KTÖS) (2014), pp. 26-27.

which played an important role in reducing the budget deficit, was freezing the Cost of Living Adjustment (COLA) in 2011. As the inflation rate in 2011 was 14.7%, in effect freezing COLA meant reducing all public sector salaries, pensions, as well as social benefits, by 14.7% in real terms.

This move has affected a considerable segment of the Turkish Cypriot community. Each month, the Turkish Cypriot Ministry of Finance issues around 41.000 pay cheques under three main categories: Around 18.500 of these recipients are those who are currently working for the public administration, either as civil servants or manual workers. The second group is pensioners, whose number is around 13.500. The remaining 9.000 are the recipients of social security benefits (KKTC Maliye Bakanlığı 2019). When we add those working in the wider public sector, whose number is around 15.500,³ the number of people whose income has been reduced by the austerity measures reaches to 56.500. Considering their dependents and given the number of voters is around 190.000, this disgruntled group makes an important pressure group. It should also be taken into consideration that in the period concerned the minimum wage was also frozen, affecting private sector employees. Indeed, even a stronger negative effect could be observed on the private sector employees as the minimum wage did not change in 2012 too.

Privatisation of some public assets was also involved in the protocol signed with Ankara. Privatising the operation of Erkan (Tymbou) airport brought in considerable revenue to the treasury, which helped to alleviate the pressure on public sector salaries and pensions in 2012. The tender process for the operation of the airport services was finalised in September 2012, and it was won by a consortium made up of two Turk-

ish companies (which hold 70% and 20% of the shares) and a Turkish Cypriot company (which holds the remaining 10%). This brought in an injection of €100 million to the budget in 2012 and in 2017, when the consortium started paying the treasury a certain amount of its profit. This was around €19 million in 2017.⁴ The Turkish Cypriot Petroleum Company (KPET) was also privatised in 2011. The tender was won by two Turkish Cypriot companies (*Haber Kıbrıs* 2011).

Although initially these measures were deemed necessary by the senior coalition partner of the then ruling coalition, left-wing, Republican Turkish Party (Cumhuriyetçi Türk Partisi, CTP), and shyly written in its election manifesto in 2009, it would not be an exaggeration to say that neither the CTP, the political class at large nor the electorate espoused these policies. Only the business community endorsed these measures (see KTÖS 2014, p. 7). As influential as they are, this group has never had political allies or a political party which openly advocates austerity. How can we explain the absence of a political party which promotes fiscal restraint? One possible explanation is that public employment has become part of the culture because of the TRNC's international isolation as well as the historical legacy of the Ottoman rule and the Cyprus conflict, as outlined above.

IMPACT OF AUSTERITY ON PUBLIC FINANCES

This section outlines the effects of austerity policies on public finances.

Government spending as a share of Gross National Product

Figure 1
Government expenditure as a percentage of GNP



Source: Devlet Planlama Örgütü (2017 and 2018a)

³ According to the latest Household Labour Survey conducted by the State Planning Organisation in October 2017, there are 34.043 people working in the public sector (State Planning Organisation 2018b).

⁴ Reportedly, this was less than half of the figure that was supposed to be paid. As the TRNC cannot effectively audit the accounts of the consortium. See Yenidüzen (2018, February 23).

was almost 48% in 2009, which was not necessarily very high by OECD standards. By 2017, this figure went down to 34,3%. In this respect, it is possible to say that, overall, various Turkish Cypriot governments which came to power in this period were successful in taming government spending (see Figure 1). Furthermore, in 2009 domestic revenues of the TRNC could meet only 61% of total budget expenditure

(see Figure 2), with Turkey plugging the deficit with loans. By 2016, this reached to 83% and remained at the same level in 2017. This can be considered another success.

Thanks to the rise in domestic revenue and the decline in public spending, by 2016, the deficit was reduced by 58,7% compared to the figure in 2009 (see Figure 3).

Figure 2
Domestic revenue/total public expenditure + tax revenue/total expenditure.



Source: Devlet Planlama Örgütü (2017 and 2018a).

Figure 3
Budget deficit (2009 = 100)



Source: Devlet Planlama Örgütü (2017 and 2018a).

However, when the composition of government spending is examined, it is seen that the change has been more moderate. In 2009, personnel expenditure and transfers accounted for 81% of the budget. In 2017, the combined figure went down to 77% (see figures 4(a) and 4(b)). Personnel expenditure alone went from 36% to 33%.

Although there is a slight decline over time, the figure is still very high compared to European countries where ‘the share

of government spending that is devoted to the compensation of government employees ranges between 5% and 15%’ (Ortiz-Ospina and Roser 2019).

How was government spending as a share of GNP reduced then? This was achieved by keeping the number of employees in the public administration more or less the same, while reducing their salaries in real terms (see Figure 5).

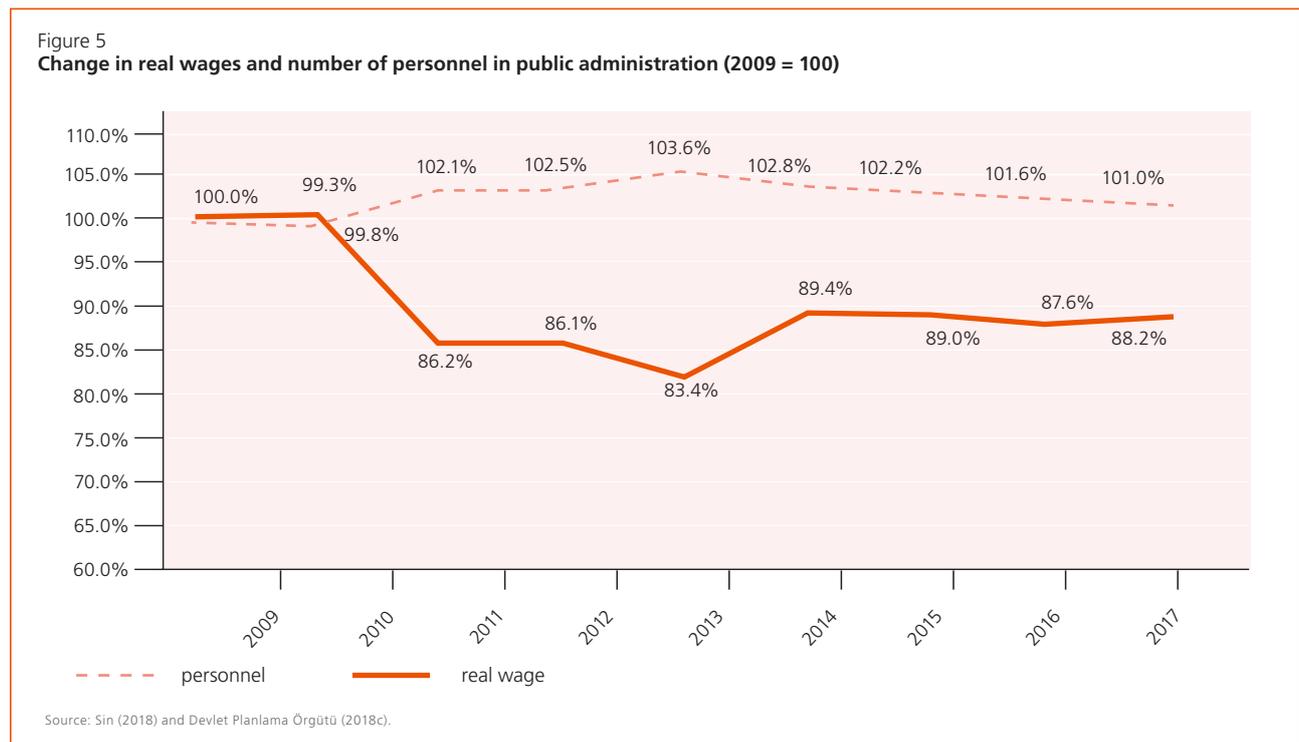
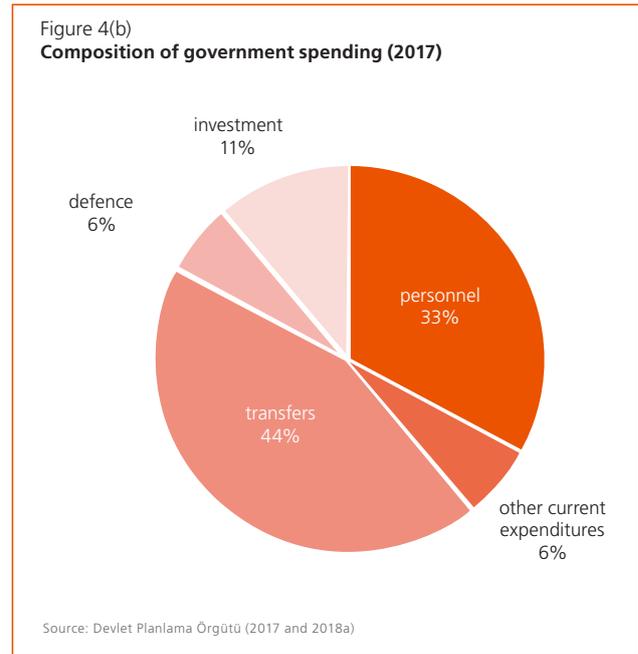
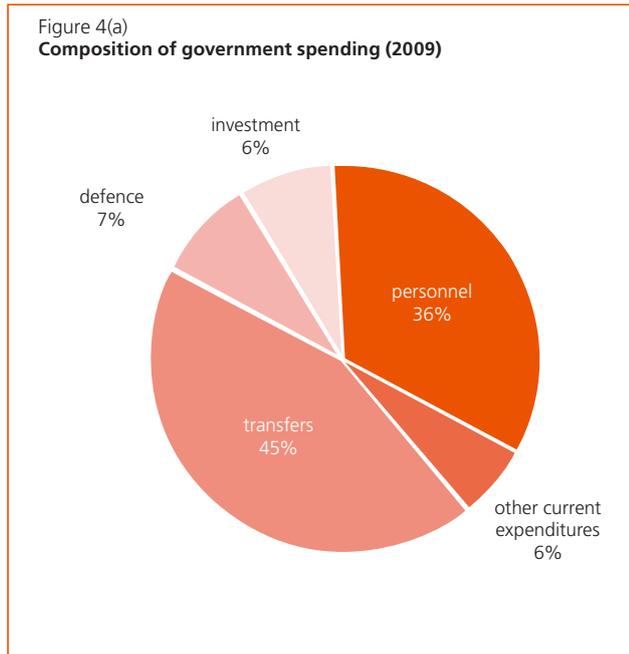
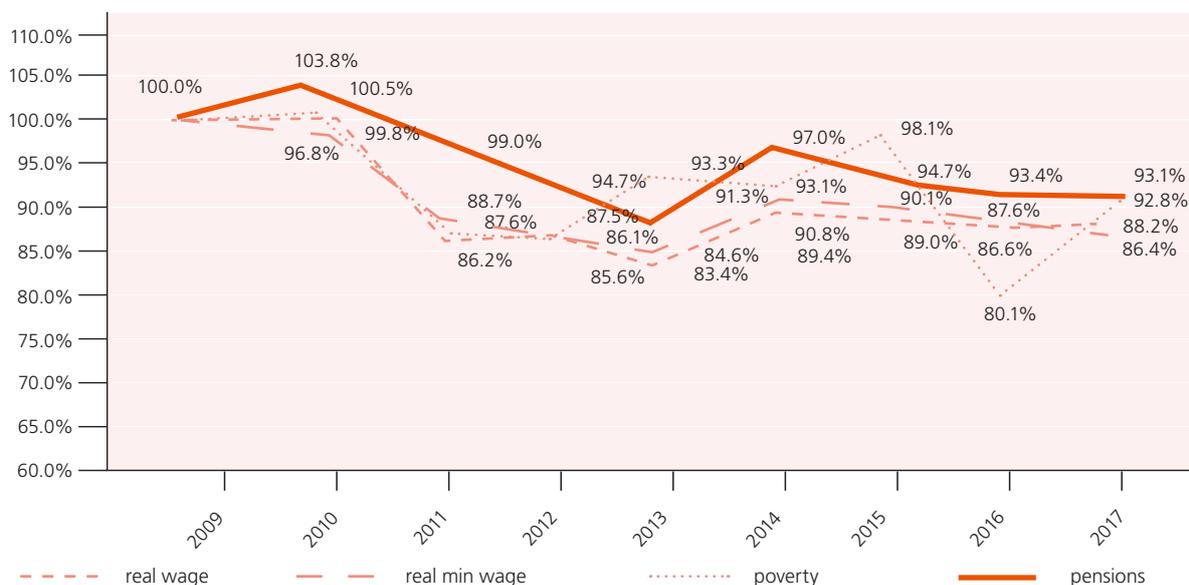


Figure 6
Change in real earnings: pensions, poverty, minimum wage, average public wage (2009 = 100)



Source: Sin (2018) and Devlet Planlama Örgütü (2018c).

Real wages were cut by freezing COLA in 2011 when inflation reached almost 15%. This has affected all public and semi-public sector employees, pensioners and recipients of social security benefits and created a lasting effect on public spending. Overall, by 2017, real incomes of those on public payroll were around 10% below their 2009 level (see Figure 6).

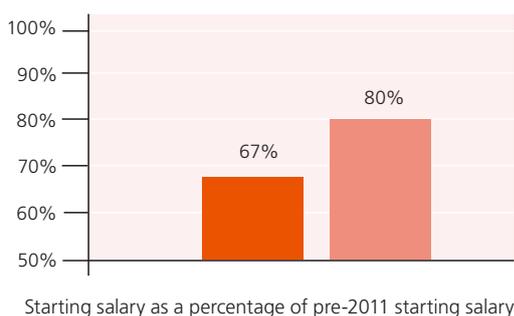
The 47/2010 law did not affect everyone employed in the public sector after 2010 the same way. For instance, the undersecretary salary was 11% below the pre-47/2010 salary scale in 2011. By 2019, the difference was narrowed to 6% (see Figure 8).

Additionally, the entry level salaries in the public administration was reduced by 33% in most positions. This is to say, a university degree holder, who started her career in public administration as of 1 January 2011, earned 33% less compared to someone with the same qualifications who had started on 31 December 2010. This was partly made up in time by offering this group pay increases that were higher than COLA. Nevertheless, the starting salary of a university degree holder in January 2019, whose employment terms are subject to the 47/2010 law, is 20% below the salary that she would have earned if 47/2010 had never been introduced.

MACROECONOMIC IMPACT OF AUSTERITY

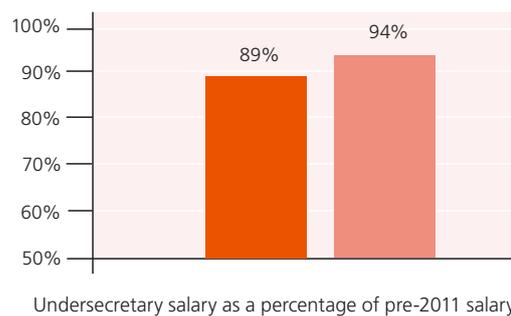
In the period under consideration, following the initial shrinking in 2009, the economy continued to grow. The contractionary effects of austerity measures on the economy were offset by the considerable rise in tourists and university student numbers enrolled in the Turkish Cypriot universities; exports also grew but the main driving force of the economy were services. Yet, in per capita income terms the level achieved before the recession could not be seen. This was

Figure 7
Starting salary of new entrants as a percentage of pre-2011 starting salary (2011 and 2019)



Source: Calculated by the authors based on salary tables provided by KTÖS (2014) and KTAMS.

Figure 8
Undersecretary salary as a percentage of pre-2011 salary (2011 and 2019)



Source: Calculated by the authors based on salary tables provided by KTÖS (2014) and KTAMS.

because the growth was attained to a large extent by cheap labour provided by the increasing number of foreign workers (See Table 1).

Unemployment

The unemployment rate went up from 9,4% in 2007 to 12,4% in 2009 but then steadily declined from then on and stood at 5,8% in 2017 (*Devlet Planlama Örgütü (2017 and 2018a)*). In a similar vein, youth unemployment figures steadily declined from 31,4% in 2009 to 17% in 2016 (and slightly went up to 18,7% in 2017) (*Devlet Planlama Örgütü Hanehalkı İşgücü Anketi Sonuçları [State Planning Organization Household Labour Survey Results]* (various years); for more on youth unemployment see Ioannou and Sonan, 2016).

Inequality

According to the household income distribution surveys, which were held in 2008 and 2015, the Gini coefficient only slightly worsened from 0,33 to 0,34 (*Devlet Planlama Örgütü 2016*, p. 1). In other words, inequality did not increase during this period of belt-tightening. It should be added that, a slight increase could be observed in the number of people below the poverty line from 14,8% to 15,4% (*ibid.* p. 2).

Healthcare

When the healthcare statistics are studied (see Table 1), it can be seen that there was a decline in the quality of the indicators of public healthcare services. Between 2007 and 2016, the number of beds in public hospitals increased from 1.022 to 1.107, whereas the number of specialist doctors working at public hospitals went up from 205 to 212. Although this can be seen as a positive development at first sight, it is im-

portant to note that in this period, the population of the country went up by 25% from 268.000 to 335.000. Therefore, in per capita terms, we can observe a worsening in both areas.

The budget figures show that the amount spent on healthcare slightly declined between 2007 and 2016, from 8,6% to 7,7%. A similar decline can be observed in health expenditure as a share of GNP, from 3,9 to 2,8%. As pointed out by a member of the executive board of the Union of Turkish Cypriot Medical Doctors (*Kıbrıs Türk Tabipler Birliği*), whom we interviewed for this report, public spending in north Cyprus on health is around half of the OECD average. Two important points were raised in our interview. First, the tightening of the healthcare budget came at a time when demand for these services rose, not only because of the rise in population but also due the decline in the purchasing power of salary earners/pensioners who used to prefer private hospitals/clinics in the past. Secondly, a significant portion of the healthcare budget goes to private hospitals because of the shortcomings in the public hospitals; this is to say, patients are referred to private hospitals when the public hospitals cannot provide the treatment required due to shortages of equipment or medication. Bills are then paid by the Ministry of Health, but as this is not based on a detailed agreement where prices are set, it leads to overcharging. 'Treatments that can be done for, say, TL100 at the public hospitals may be done for TL1000 in a private hospital' according to our interviewee. In other words, with the amount of money sufficient to treat 10 patients, only one patient is treated; a clear case of misallocation of public funds.

Figure 9
Turkish grants & credits (in 2009 prices)



Source: Kendirci et al. 2018.

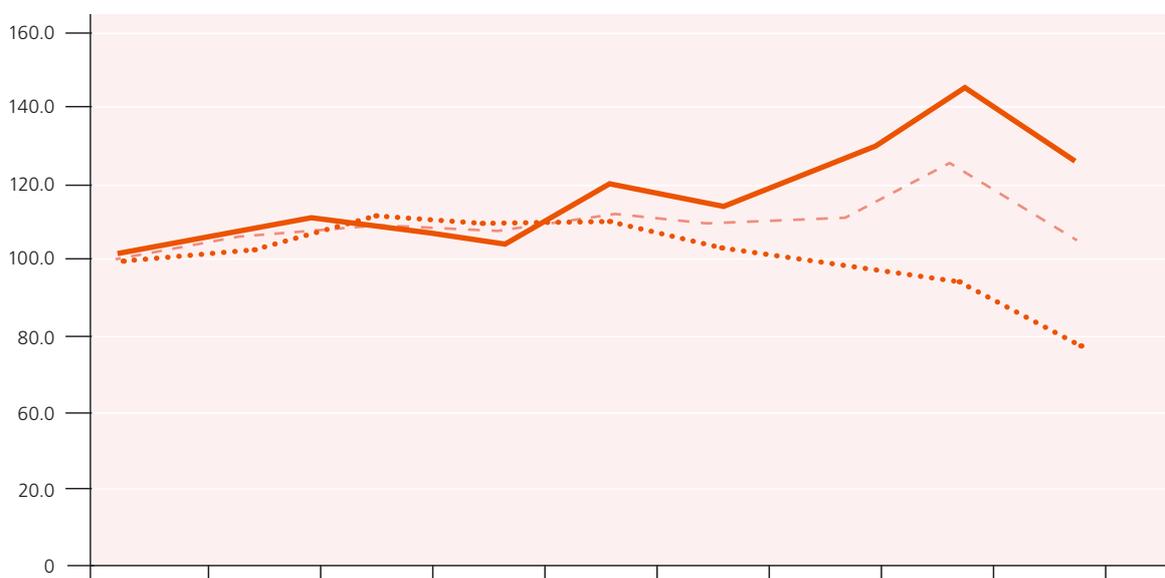
Financial Dependence on Turkey

In this period, dependence on Turkey for loans to finance the budget deficit has steadily decreased. However, still a serious amount of funds has been channelled to support the real sector and improve the physical infrastructure. In other words, in the period under consideration, while the annual amount of grants received went up, the annual amount of loans declined (see Figure 9).

Obviously, this can be seen as a success and a promising development, which shows that the Turkish Cypriot economy

can stand on its feet in a post-settlement, reunified Cyprus. On a bleaker note, however, it should be added that the public debt stock is still high (see Figure 10). In the period concerned, foreign debt, i.e. debt owed to Turkey, has increased by almost 25%. Domestic debt, on the other hand, has declined by more than 20% in real terms, which was good news and in line with the initial targets of the programme showing that the government’s crowding out effect has decreased.

Figure 10
Public debt stock (2009 = 100)



	2009	2010	2011	2012	2013	2014	2015	2016	2017
-- total	100.0	106.5	108.9	104.6	115.7	111.5	117.8	124.1	106.8
•• domestic	100.0	102.1	111.3	108.6	108.8	101.5	96.2	94.5	79.6
— foreign	100.0	109.4	107.3	102.0	120.1	117.9	131.8	143.3	124.4

Source: Kendirci et al. 2018, p. 84.

Household Debt

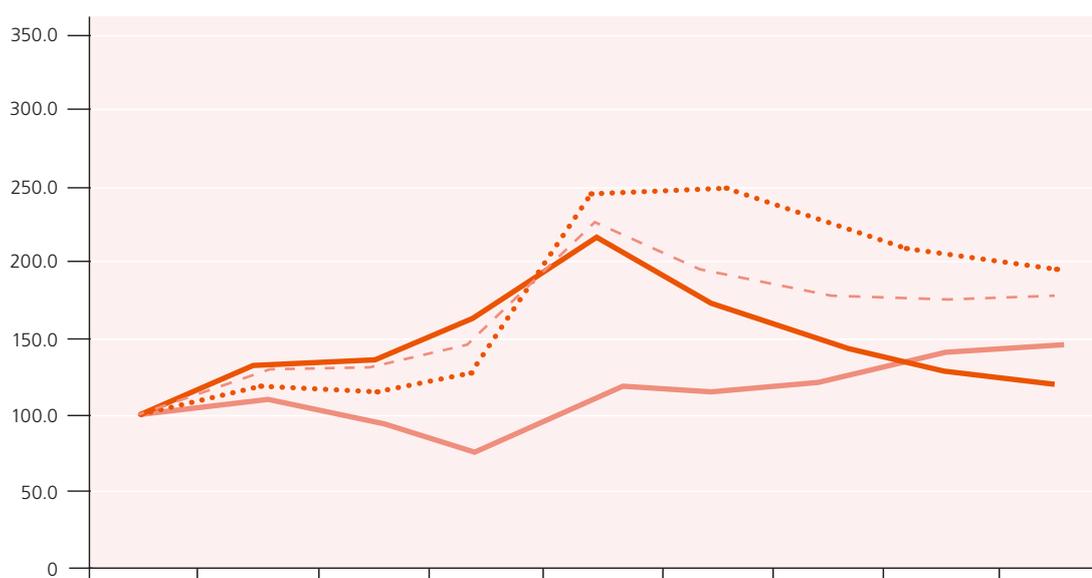
The literature shows that in many Western countries (see for instance Barba and Pivetti 2009) and Turkey (Akçay 2018) stagnating real wages led to growing household debt. That is why we decided to test whether this took place in our case too. Our findings show that the same could be argued for the case of TRNC. The Central Bank figures indicate that between 2009 and 2017, household debt in per capita terms grew by 75% (see Figure 11).⁵ As our denominator is the number of people employed, which includes a sizeable number of low-wage migrant workers who are willing to save as much as they can and are therefore less likely to borrow from banks, it could be argued that the per capita debt burden is likely to be much higher than our figures reflect. Our hypothesis is that people who did not want to change their consumption patterns chose to borrow from banks to make up for loss in their real incomes. A banker interviewed for this report pointed out that the banks came up with various schemes to meet public employees' growing demand for credit. To give a specific example, at some point, Vakıflar Bankası, a public bank, offered a 'salary credit', [which may be

as much as 40 times the borrower's salary with up to 144 months of maturity] or '13th salary credit' (Vakıflar Bankası 2019). The salary credit's terms were later limited by the Central Bank. A public bank employee interviewed for this study said that more and more public sector employees were borrowing money to pay for existing debt; 'the 13th salary [which is paid by the government in December] is already spent in May'. Another bank manager working for a private bank also confirmed the trend.

The figures presented here are probably still an understatement because there is also a sizeable 'financing/factoring/loan sharking sector', which is not regulated and hence there are no official figures. Anecdotal evidence, however, suggests that there are many big businesses as well as individuals who are entangled in debt trap of these institutions.

Figure 11

Loans – auto and consumer loans and credit card debts / employed (2009 = 100)



	2009	2010	2011	2012	2013	2014	2015	2016	2017
— auto loans	100.0	104.0	89.1	76.4	121.3	118.2	122.9	146.2	148.1
— consumer loans	100.0	131.3	139.2	154.8	209.8	170.9	146.4	139.8	136.4
•• credit cards	100.0	113.2	112.5	129.7	247.1	249.9	239.3	209.2	195.9
- - total	100.0	127.0	134.4	148.1	215.9	191.8	174.8	173.2	174.7

Source: KKTC Merkez Bankası (2019) and State Planning Organization's Household Labour Force Surveys (various years).

⁵ Our dataset for credit figures start from January 2010 and end in January 2018. Our dataset for the number of people in employment reflects the surveys conducted in October each year from 2009 to 2017.

Competitiveness

One of the major aims of the programmes was to improve the competitiveness of the private sector. According to the authors of the annual competitiveness report by the Turkish Cypriot Chamber of Commerce:

What is worse, for the past ten years, there has not been a significant improvement in the competitiveness of the

country. This demonstrates that Northern Cyprus could not bring about the necessary reforms and could not engage in a transformation that would boost development (Besim, Sertoğlu and Ekici 2018, p. 7).

The figures in Table 2 confirm the conclusion reached by Besim, Sertoğlu and Ekici.

Table 2
Competitiveness scores and rankings of the north Cyprus

Year	Score	Rank	Number of countries studied
2008-09	3,43	117	135
2009-10	3,66	99	134
2010-11	3,51	117	140
2011-12	3,58	118	142
2012-13	3,54	123	144
2013-14	3,64	118	148
2014-15	3,68	114	144
2015-16	3,56	121	141
2016-17	3,70	114	139
2017-18	3,77	109	137

Source: Kıbrıs Türk Ticaret Odası (various years).

Political Impact

The measures took on the most organised segment of the Turkish Cypriot society: the public sector employees, who make up the overwhelming majority of trade union members, which are almost solely organised in the public sector. Although this has initially pushed the trade unions across the political spectrum together to organise massive demonstrations, in the face of Ankara's resolve, public anger gradually changed to cynicism and anti-austerity protests subsided.

As in other countries where austerity policies have been implemented, the political impact of belt-tightening policies on the political establishment has been remarkably negative. The fact that political parties did not/could not keep the promises they made when they were in opposition seriously undermined public trust in politicians and elected bodies. Political parties constantly trail behind every other institution in public opinion polls (see Ernur 2019; Sözen and Sonan 2019, p. 145). None of the political parties was bold enough to claim ownership of the programmes they signed and indeed the implementation did not go beyond the bare minimum required to keep finances flowing from Turkey. Nevertheless, as Sözen and Sonan (2019) showed in their study on the political effects of austerity, even this was enough to anger voters.

As a manifestation of growing voter dissatisfaction, the turnout in general elections in the period under study has constantly declined while the number of invalid votes went up; both the abstention rate and invalid votes peaked in the last general elections held in early 2018 (Table 3).

As in other Southern European countries which have gone through austerity (see Bosco and Verney 2012), squeezed between their external commitments (to financial protocols signed with Ankara in the Turkish Cypriot case) and domestic popular backlash, governing parties found it increasingly difficult to govern. The last three general elections had to be called earlier than the end of the parliamentary term. In early general elections of 2009, the CTP, which had won the previous election by a landslide, was punished by the voters for putting austerity measures on the parliament's agenda – particularly the so-called *Göç Yasası* (the Law Regulating the Monthly Salary, Wage and Other Allowances of the Public Employees). The UBP, which won enough seats to form a single party government (a rare feat in Turkish Cypriot electoral system) largely thanks to its electoral platform ruling out austerity, could not finish the parliamentary term when it reneged on its promises. Its leader, who the public considered 'overly keen to carry out economic austerity measures' (Bahçeli 2013), could not even get elected to the parliament. The

Table 3
Votes in the general elections

	2009 Early Elections		2013 Early Elections		2018 Early Elections	
	Vote (%)	Seats	Vote (%)	Seats	Vote (%)	Seats
UBP	44.0	26	27.3	14	35.6	21
CTP	29.3	15	38.4	21	21.0	12
HP	-	-	-	-	17.0	9
TDP	6.9	2	7.4	3	8.7	3
DP	10.6	5	23.1	12	7.8	3
YDP	-	-	-	-	7.0	2
BDH	-	-	-	-	-	-
ÖRP	6.2	2	-	-	-	-
No-seat-parties	3.0	-	3.8	-	2.9	-
UBP-CTP	73.3	41	65.7	35	56.6	33
Right-wing votes	61.4	31	50.5	26	50.6	26
Left-wing votes	38.5	17	49.0	24	32.3	15
Turnout (%)	81.7	-	69.4	-	66.1	-
Invalid votes (%)	5.8	-	6.6	-	11.1	-

Source: Sözen and Sonan 2019

first grand coalition in Turkish Cypriot politics between CTP and UBP, which had been formed with much fanfare, lasted less than one year and came to an end due to a disagreement between the coalition partners over the privatisation of water utilities: a demand from Ankara.

The fact that public sector employees, pensioners and recipients of social security benefits all saw their real incomes decline, and the perception that austerity measures were imposed by Ankara created a political backlash against the governing parties across the political spectrum. The com-

bined votes of the two main parties, UBP and CTP, went down. It is important to note that left-wing parties were affected worse than right-wing political parties from the backlash created by austerity; 'combined votes of the pro-reunification left went down to 32,3%, its second-worst performance since 1976' (Sözen and Sonan 2019, p. 147). Recently, growing dissatisfaction with the mainstream political parties gave rise to the formation of two start up parties: People's Party (*Halkın Partisi*, HP) and Rebirth Party (*Yeniden Doğuş Partisi*, YDP), which among themselves garnered close to 25% of the votes in the first election that they contested in 2018.

CONCLUSIONS

Contrary to the majority of countries that have gone through periods of fiscal restraint in the past 10 years, in the case of north Cyprus, austerity measures were not introduced solely to address the adverse yet temporary effects of the Great Recession on public finances. But rather these policies were devised to overhaul the politico-economic structure of a small, de facto state, which has been isolated from the rest of the world for half a century and dependent on financial assistance from another country: i.e. Turkey. The change in Ankara's attitude towards the Cyprus problem with the coming to power of the Justice and Development Party (AKP) in Turkey in 2002, also led to a change in economic policy towards the northern part of Cyprus. Ankara has become more reluctant in financing, what it sees, as the of profligacy of Turkish Cypriot politicians.

The most obvious problem of the Turkish Cypriot economy has been the huge share of the personnel and transfer expenditures in the public budget, which stem from decades of clientelistic expansion of the public sector. Accordingly, one of the key targets of the austerity policies was reducing the attractiveness of the public-sector jobs. There were three main policy instruments: (1) reducing the entry level salaries of public sector employees, (2) freezing all salaries, pensions and social security payments in real terms for a year in 2011, and (3) reforming the pension system.

The results of these policies have been mixed. The budget deficit has been reduced. However, public debt stock as a share of GDP is still high. The economy seemed to be growing but has failed to generate white collar jobs that would satisfy young university graduates. By 2017, the GNP in dollar terms was below its 2008 level. The main engine of growth has been the service sector, whose demand has been limited to low-wage migrant workers. This is a particular setback for efforts to make the private sector more attractive to young Turkish Cypriots, because the gross enrolment ratio in tertiary education in the period concerned rose to over 90%. That is to say, the private sector can be attractive only to the extent that it creates jobs for university graduates, which is obviously not the case.

In a similar vein, although entry level salaries in the public sector have been reduced in real terms, as working conditions in the private sector have not been improved, public sector jobs remain 'the greatest object of desire' for a major-

ity of Turkish Cypriot employees. The level of unionisation in the private sector remains at negligible levels while labour laws in general are not fully enforced, making most private sector employees work in precarious conditions (see Ioannou and Sonan 2014).

Austerity policies can be considered successful in the sense that financial dependence on Turkey has steadily decreased in the period concerned. This can be seen as good news in the context of inter-communal negotiations between the Turkish Cypriot and Greek Cypriot sides because a viable economic system in the northern part of Cyprus may help to change the negative perception in the south that Turkish Cypriots would constitute a burden on the federal state. On the downside, in the meantime, a considerable amount of debt has been accumulated by the TRNC as borrowing from Turkey continued.

On the political front, no political party claimed ownership of these programmes and the implementation did not go beyond the bare minimum required to keep Turkish finances flowing. Nevertheless, even this was enough to anger voters. The fact that public sector employees, pensioners and recipients of social security benefits all saw their real incomes decline and perceived that Ankara imposed the austerity measures created a political backlash against the governing parties across the political spectrum. The last three general elections were all called earlier than scheduled while turnout steadily declined, a manifestation of growing political discontent among Turkish Cypriot voters.

Although financial dependence on Turkey has subsided, there is no sign of decline in Turkey's political influence. Furthermore, as no end is in sight for austerity policies, this trend is likely to continue putting more strain on the political system. This may lead to an increase in calls for a change in the governmental system, and a referendum on the presidential system in the near future should not come as a surprise.

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IMPRINT

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SOCIO-ECONOMIC AND POLITICAL IMPACT OF AUSTERITY POLICIES IN NORTH CYPRUS

A Brief Assessment

Since 2010 Turkish Cypriot governments have been implementing various austerity measures based on economic programs agreed with the Turkish government. This report aims to make a brief evaluation of the impact of these measures on Turkish Cypriot economy, society and politics by (1) using official statistics, and (2) conducting interviews with a number of experts and practitioners. The most obvious problem of the Turkish Cypriot economy has been the huge share of the personnel and transfer expenditures in the public budget, which stem from decades of clientelistic expansion of the public sector. Accordingly, one of the key targets of the austerity policies was reducing

the attractiveness of the public-sector jobs. There were three main policy instruments: (1) reducing the entry level salaries of the public-sector employees, (2) freezing all salaries, pensions and social benefits in real terms for a year in 2011, and (3) reforming the pension system. The results of the austerity policies have been mixed. Public sector employees, pensioners and recipients of social benefits all saw their real incomes decline. As a result, the budget deficit has been reduced. However, public debt stock as a share of GDP is still too high. Furthermore, people chose to borrow to make up for loss in their real incomes and therefore household debt increased too. The economy see-

med to be growing but by 2017, the GNP in dollar terms was below its 2008 level. On the political front, externally imposed austerity measures created a backlash on the governing parties across the political spectrum and made governing more difficult. The last three general elections were all called earlier than scheduled while turnout steadily decreased, a manifestation of growing political discontent among voters. As no end is in sight for austerity policies, this trend is likely to continue putting more strain on the political system. Finally, though financial dependence on Turkey has subsided, there is no sign of decline in Turkey's political influence.