



## Cyprus: a political and economic overview

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Cyprus has been divided between the Greek community in the south and the Turkish community in the north since 1974, following growing inter-communal violence. Each side now has its own institutions, and UN troops patrol the 'Green Line' between the two. The Republic of Cyprus officially includes the whole island, but usually refers to the (Greek Cypriot) government-controlled south. The 'Turkish Republic of North Cyprus' is recognised only by Turkey.

A series of UN-brokered settlement negotiations culminated in referendums in both communities on the 'Annan plan' in 2004, but this plan was rejected by the Greek community which was about to join the EU regardless of the outcome. A period of little progress followed, although the outline of a settlement has already been agreed: Cyprus is to become a single federal republic consisting of two zones and two communities with far-reaching autonomy.

The election of a pro-reunification President of the Republic of Cyprus, Demetris Christofias, in February 2008 brought a renewed sense of optimism to those eager for a solution. A series of talks and negotiations between the two sides soon began on contentious issues including power structures, Turkish troops, property issues and the rights of settlers from mainland Turkey. There were also important symbolic gestures such as the opening of a new crossing-point between north and south. However, this good-will has yet to translate into a substantive settlement, and many commentators have suggested that the current window of opportunity may well be closed if the presidential elections in the north in April 2010 bring in a nationalist president. The current prospects for a settlement have been put at about two in five.

As the global economic crisis has developed, the economy of the Republic of Cyprus has suffered a slowdown, with contraction now expected in 2009, and deteriorating public finances. The economy of the north continues to be seriously hampered by its political isolation, and there are some fears that without a settlement deal, the economies of both communities could be damaged.

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# 1 A divided island<sup>1</sup>

## 1.1 Historical background

Cyprus became independent from the UK on 16 August 1960. The new republic's constitution provided for a system of government in which power would be shared by the Greek and Turkish communities in proportion to their numbers, and a set of Treaties of Alliance and Guarantee that gave both Greece and Turkey a right to intervene to guarantee Cyprus's constitutional order and to keep troops on the island. However, long-running frictions between the Turkish and Greek communities remained, with the Greek community tending to favour a unitary state (or even at several points unification with Greece) and the Turkish community seeking a federation with a high degree of autonomy, or outright independence.

In 1963 the Turkish community stopped participating in the government, and the island has been divided since 1974, when Turkish troops occupied the north to protect the Turkish community from a feared Greek takeover. A *de facto* government was established in the north the following year, divided from the rest of the island by the 'Green Line' which is patrolled by UN forces ([UNFICYP](#) – the United Nations Peace-Keeping Force in Cyprus).<sup>2</sup> The UK retains sovereignty over two military bases on Cyprus.

Although the 1960 constitution remains nominally in force for the Republic of Cyprus, each community administers its own affairs, refusing to recognise the authority of the other's government.

## 1.2 Republic of Cyprus

The Greek Cypriot administration claims to be the Government of all Cyprus and (other than by Turkey) is internationally recognised as such even though it has no Turkish participation.

The President of the Republic of Cyprus is elected for a term of five years and appoints a Council of Ministers. The current President is Demetris Christofias, following the elections of 17 and 24 February 2008. He is the EU's first (nominally) communist head of state. He leads a coalition government comprising his Progressive Party of the Working People (AKEL), the 'centrist' Democratic Party (DIKO) of former President Tassos Papadopoulos, the Social Democrats (KISOS) and AKEL-backed independents.

The House of Representatives of the Republic of Cyprus comprises 56 deputies, who are elected for a five-year term (under the 1960 Constitution, as amended in 1985, the House of Representatives officially comprised 80 seats, of which 24 were allocated to Turkish Cypriots), plus three observer members representing the Maronite, Latin and Armenian minorities. The last elections were held on 21 May 2006, resulting in no major changes to its composition and a continuation of the AKEL/DIKO-led coalition. AKEL and the opposition centre-right Democratic Rally (DISY) won 18 seats each while DIKO secured 11 seats and KISOS five. Also securing representation were the European Party with three seats and the Cyprus Green Party with one. Although maintaining their dominant positions, both AKEL and the pro-settlement Democratic Rally (DISY) lost support to DIKO and the European Party which take a harder line on compromise with the Turkish Cypriot community in northern Cyprus.

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<sup>1</sup> This section draws on the 'Cyprus' entries in [Europa World online](#), available through the House of Commons intranet (retrieved 27 October 2009).

<sup>2</sup> [UN Security Council Resolution 186](#) (1964)

The next parliamentary election in the republic of Cyprus is due in May 2011.

### **1.3 'Turkish Republic of Northern Cyprus'**

On 15 November 1983 the 'Turkish Republic of Northern Cyprus' ('TRNC') was established following a unilateral declaration of independence. It is recognised only by Turkey, and the declaration of independence was condemned by the UN Security Council.

The 'TRNC' elects its own 50-member Legislative Assembly for a term of five years and has an independent judicial system. The President of the 'TRNC' is elected for a term of five years and appoints a Prime Minister, who forms a 10-member Council of Ministers. The current President is Mehmet Ali Talat, who had been Prime Minister before winning the presidential election on 17 April 2005, and who favours reunification. The next presidential election is scheduled for April 2010, with some indications that it might be won by nationalists.

It was announced in mid-February 2009 that the 'TRNC' would hold early parliamentary elections for its Legislative Assembly in April 2009. This was a year ahead of schedule, and was reportedly an effort by the 'TRNC' Government to ensure that the Legislative Assembly was able to offer adequate support to the Turkish Cypriot community in the ongoing reunification talks with Greek Cypriots. At the election, the National Unity Party (UBP), which has long been an exponent of the 'TRNC' as an independent nation, secured 44% of the votes cast and increased its representation to 26 seats (from 17 in 2005), while the party of President Talat (the Turkish Republican Party, CTP), garnered only 15 seats (a loss of 10) and 29% of the votes (down from 44% in 2005).

The UBP, led by former Prime Minister Derviş Eroğlu, formed a new government. Under pressure from Turkey, which feared that the UBP's nationalist stance would threaten the settlement negotiations and thus Turkey's hopes of joining the EU (see below), the UBP government soon announced that it would support ongoing reunification talks between Talat and Christofias. Nonetheless it was widely felt that the victory by the UBP would almost certainly have a negative influence negotiations with the Greek Cypriots.

### **1.4 2004: the 'Annan plan' and the joint referendums**

UN-sponsored peace talks have taken place on and off for many years, with various plans rejected by one or other community. The prospect of EU membership for Cyprus concentrated minds towards a settlement, and from 1999 to 2003 the then UN Secretary-General, Kofi Annan, [worked on a plan](#) for the reunification of Cyprus which provided for a federation of two politically equal states. He wrote into the plan that it would have to be adopted by referendum in both parts of Cyprus and so, following negotiations between the governments of Greece and Turkey on the plan, a [revised version](#) was put to twin referendums in Cyprus on 24 April 2004.

The Turkish Cypriot community voted in favour but the Greek Cypriot community voted against the plan, meaning that it could not be implemented. For the Greek Cypriots the most contentious parts of the plan were those relating to Turkish troop levels on the island, the territorial adjustment between the two parts of Cyprus, and the return of refugees to their homes. An overarching concern was that, in the view of many Greek Cypriots, the plan favoured Turkey and legitimised the consequences of the Turkish intervention in 1974. And when it had become clear that Cyprus was going to join the EU, divided or not, a strong incentive for the Greek Cypriots to accept a settlement had been removed.

For some years after the referendum there were few, if any developments indicating that the parties concerned were ready to once again broach the issue of a comprehensive settlement on Cyprus. Indeed, relations between the key protagonists were characterised by a serious lack of trust and understanding.<sup>3</sup> The re-election in May 2006 of coalition parties in the Republic of Cyprus that are opposed to the Annan Plan led analysts to agree that, in the short term at least, no new momentum would be injected into the peace process.

### **1.5 2008: pro-reunification leaders in both communities**

Prospects for a settlement then improved markedly with the election of the pro-reunification AKEL leader Demetris Christofias as President of the Republic of Cyprus in February 2008. He replaced Tassos Papadopoulos, who had favoured a less compromising approach towards the Turkish Cypriots. Christofias's main campaign theme was ending the division of the island, and as soon as he took office he began initial talks with the pro-reunification leader of the Turkish Cypriots, Mehmet Ali Talat. The two men have known each other for many years, and have a good personal and political relationship.

In a hugely symbolic gesture, on 3 April 2008 the barriers came down in Ledra Street to create a new crossing-point between north and south at a key thoroughfare in the heart of the Cypriot capital Nicosia.

At a meeting on 23 May 2008 hosted by the UN Secretary-General's newly-appointed Special Representative in Cyprus, Tayé-Brook Zerihoun of Ethiopia, Christofias and Talat reiterated their 'commitment to a bizonal, bicomunal federation with political equality, as defined by relevant Security Council resolutions'. This agreement had been reached in 1977 but has not yet been implemented.

Then on 25 July 2008 Christofias and Talat agreed to begin formal bilateral talks on reunification, with a limited role for Zerihoun and Alexander Downer, who had just been appointed as the UN's Special Adviser on Cyprus. The leaders have maintained a steady pace of almost one meeting per week, and their efforts have also been supported by a gradually increasing number of preparatory meetings between their respective representatives, George Iacovou (Greek Cypriot) and Ozdil Nami (Turkish Cypriot), as well as technical meetings at the expert level.

These meetings, which are intended to facilitate consensus on matters ranging from power-sharing and governance to security, property and the environment, began on 3 September 2008. Although, as noted above, the outline of a settlement has already been agreed – Cyprus is to become a single federal republic consisting of two zones and two communities with far-reaching autonomy – this general statement masks important differences of opinion. In general, Greek Cypriots want to keep as much power as possible with the federal government and ensure that the new state is a continuation of the Republic of Cyprus, whereas Turkish Cypriots want to keep as much power as possible within the two 'constituent states' and ensure that their own entity is treated as an equal founder.<sup>4</sup> There are also other difficult questions including security (the status of Turkish troops and of the 1960 Treaty of Guarantee), the residence and citizenship rights of settlers from mainland Turkey and property issues (see below).<sup>5</sup> In October 2008 Downer said, "It's going to take a

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<sup>3</sup> See *Cyprus: Recent Developments*, Library Standard Note SN/IA/04218, 8 January 2007

<sup>4</sup> International Crisis Group, *Cyprus: Reunification or Partition?*, Europe Report N°201, 30 September 2009, p4

<sup>5</sup> Toby Vogel, 'Greek and Turkish communities to start talks in September', *European Voice* 31 July 2008

long time and it's going to be a difficult negotiation. But what you have here is a political will, and the political will is very good.”<sup>6</sup>

## 1.6 2009: still no agreement

In spite of the considerable optimism generated amongst pro-reunificationists by these long-awaited negotiations, familiar tensions – principally over issues of power-sharing – soon began to hamper the progress of the meetings. At the close of their first meeting of 2009 (held in Nicosia on 5 January), Christofias and Talat acknowledged that, while they continued to be fully committed to finding a lasting settlement to the island's problems, progress so far had been insufficient.

By May 2009 the UN Secretary-General was less optimistic about the political will, and was concerned that practical confidence-building measures that the two sides had agreed had not been implemented:

It is disappointing that, since the agreement on nearly two dozen confidencebuilding measures during the preparatory phase of the talks, the parties have made little progress on their implementation during the reporting period. The original agreement had been received as a welcome breakthrough, not only for improving the daily life of many Cypriots across the entire island but also for encouraging and facilitating more interaction between the two communities. The apparent lack of political will to implement the agreed measures constitutes a missed opportunity in building public support within the communities for the process and creating an improved intercommunal atmosphere crucial to a future united Cyprus. In the same vein, military and other confidence-building measures, such as the creation of crossings, including at Limnitis/Yeşilirmak, and the implementation of the second phase of the restoration of the Ledra Street crossing, which UNDP stands ready to fund, would greatly contribute to an improvement in the atmosphere on the island. I call upon the parties to implement these measures without further delay.<sup>7</sup>

The first round of negotiations ended on 6 August 2009 and a second round began on 10 September 2009 (having been delayed for a week following disputes over the passage of a group of Greek Cypriots through the Turkish-occupied north to the St Mamas Church in Morphou for a service celebrating the saint's day).<sup>8</sup> The talks are now taking place twice a week, and although some progress has been made on governance and EU issues and the economy, the interlinked questions of property and territory remain unresolved.

A particularly troublesome issue is the disputed ownership of many properties in northern Cyprus, with thousands of claims to ownership of properties from people displaced during the events of 1974.<sup>9</sup> The European Court of Human Rights (ECtHR) has ruled in a number of cases that owners of property in northern Cyprus prior to 1974 continue to be regarded as the legal owners of that property, despite purported sales to new owners. On 18 November 2009, the Grand Chamber of the ECtHR will consider the effectiveness of the new Turkish Cypriot Property Commission in *Demopoulos v Turkey* and seven other test cases.<sup>10</sup> In April

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<sup>6</sup> 'Downer – negotiations', *Cyprus News Agency* 13 October 2008

<sup>7</sup> UN Security Council, *Report of the Secretary-General on the United Nations operation in Cyprus*, S/2009/248, 15 May 2009, p10

<sup>8</sup> See Michael Jansen, "Pilgrimage row holds up Cyprus negotiations", *Irish Times*, 5 September 2009 and International Crisis Group, *Cyprus: Reunification or Partition?*, Europe Report N°201, 30 September 2009, n222

<sup>9</sup> For background see *Compensation for property expropriations in Northern Cyprus and for German World War II crimes*, Library Standard Note SN/IA/4057, 29 February 2008

<sup>10</sup> Cases 46113/99, 3843/02, 13751/02, 13466/03, 14163/04, 10200/04, 19993/04, 21819/04

2009, the European Court of Justice ruled that EU courts should enforce a Greek Cypriot judgment on a disputed property which stated that a British couple who had purchased land in the north that had been owned by a Greek Cypriot who had fled to the south in 1974 should demolish their villa and leave.<sup>11</sup> Talat has described a mechanism for the return of property to rightful owners as being a “make-or-break” issue for the reunification talks,<sup>12</sup> but there is still no agreement on compensation versus restitution or return.

The progress of the talks and trust in the process was severely hampered in early October 2009 when a professional hacker broke into the UN email system and accessed Downer’s notes on the talks. One document apparently classified DIKO personnel according to their views on the settlement question. It provoked a furious reaction from DIKO and some parts of the Cypriot press, though it did not contain any information on DIKO positions that was not already in the public domain.

The degree of international engagement is a crucial aspect of the settlement talks. The International Crisis Group suggests that there are at least eight parties – Greek Cypriots, Turkish Cypriots, Turkey, Greece, the UK, EU, US and UN – with “individual, direct and vital roles in the dispute”. The group’s report assesses in detail the positions of each of these parties. It sees their role as vital but fears that “it is hard to overstate the fatigue and disinterest felt in the international community over Cyprus”.<sup>13</sup> By contrast, David Hannay, who was UK Special Representative for Cyprus from 1996-2003, suggested that the international community (other than the UN) should play a more discreet role than in the past:

With the benefit of hindsight I believe that those of us from outside the island came to play too prominent a public role in the last major effort to reach a settlement. That enabled Cypriots, particularly Greek Cypriots, to blame outsiders for everything they did not like about the Annan plan even when the compromises were in fact ones fashioned by their own leaders. So it is essential that on this occasion the two sides in Cyprus should take full ownership of whatever is negotiated. Naturally there will have to be some outsiders involved in facilitating the negotiations and helping to nudge the parties towards compromise. But that external involvement needs, I believe, to be more discreet than in the past, and at every stage the UN and its representatives need to remain centre stage, supported from the wings by the members of the Security Council to whom they report.<sup>14</sup>

In the current talks between Christofias and Talat, the UN is limiting its role to “easing contacts” and the EU is mostly absent.<sup>15</sup>

## 2 The EU-Cyprus-Turkey nexus

Cyprus joined the EU a week after the referendum on the Annan plan, on 1 May 2004, still divided. Many commentators argue that this both removed the Greek Cypriot community’s major incentive for reunification and needlessly antagonised Turkey. One report suggests that the EU’s promise to Greek Cypriots that they would join the EU whatever the result of

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<sup>11</sup> Case C-420/07 *Apostolides v Orams*, ECJ judgment of 28 April 2009. See “Greek Cypriots can claim back land, EU court says”, *EU observer*, 29 April 2009

<sup>12</sup> “Cyprus: call to speed up peace talks”, *European Voice*, 17 September 2009, p5

<sup>13</sup> International Crisis Group, *Cyprus: Reunification or Partition?*, Europe Report N°201, 30 September 2009, p21

<sup>14</sup> David Hannay, “Cyprus: the costs of failure”, *Centre for European Reform*, 1 September 2009

<sup>15</sup> Sven Gunnar Simonsen, “Best Chance, Last Chance”, *The World Today*, vol65 no11, November 2009, p26

the referendum was in fact partly based on a mistaken expectation of a Greek Cypriot 'yes' and a Turkish Cypriot 'no'.<sup>16</sup>

The whole of the island is in the EU, but European legislation and the rest of the *acquis communautaire* is suspended in the north, in line with Protocol 10 of the *Accession Treaty 2003*. In other words, European law applies to the whole of Cyprus but will not be applied in the north until a solution to the Cyprus problem has been reached. However, the suspension does not affect the personal rights of Turkish Cypriots as EU citizens: they are citizens of a Member State, the Republic of Cyprus, even though they live in the northern part of Cyprus.<sup>17</sup> The "Green Line Regulation", adopted in 2004,<sup>18</sup> deals with the movement of goods and persons across the line; trade across the green line is still severely restricted (valued at around €600,000 a month)<sup>19</sup> despite recent relaxations.<sup>20</sup>

The Cyprus issue is intricately bound up with Turkey's application to join the EU.<sup>21</sup> On the one hand, without a deal on Cyprus, Turkey's accession process is likely to grind to a standstill. On the other hand, the negotiations over Cyprus are and will continue to be strongly influenced by the prospects for Turkey's accession bid; and Turkey is most unlikely to support settlement terms acceptable to the Greek Cypriots if it feels rebuffed by the EU.<sup>22</sup>

On the first of these points, Turkey does not recognise the Greek-Cypriot government of the Republic of Cyprus as legitimate, and therefore refused to open its ports and airports to Greek-Cypriot ships and aircraft following Cyprus's accession to the EU. Because this breaches EU customs union rules (the 'Ankara Protocol'), several of the existing Member States said they would use their veto to block Turkey's already long-running accession negotiations. Instead a compromise was agreed: eight of the negotiating chapters would be 'frozen' until progress on 'key issues' had been made. Turkey views this as politically motivated, particularly in the choice of eight core chapters rather than just the one on free movement of goods. Furthermore, the Republic of Cyprus is apparently informally blocking agreement on some of the other negotiating chapters<sup>23</sup> (Turkey, for its part, continues to veto Cyprus's membership of several international organisations and arrangements).<sup>24</sup> There had been some predictions that the European Commission's latest progress report on Turkey might take a hard line on the (lack of) progress on the Cyprus issue and include measures to be taken by the EU as a result, but in the event, the report published in October 2009 took a very similar approach to previous years. It simply calls on Turkey to take practical steps towards finding a solution to a Cyprus settlement and to implement the Ankara Protocol fully:

Turkey continued to express public support for fully fledged negotiations between the leaders of the Greek-Cypriot and Turkish-Cypriot communities under the good offices of the UN Secretary-General aimed at a fair, comprehensive and viable settlement of the Cyprus problem within the UN framework, in accordance with the relevant UN

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<sup>16</sup> International Crisis Group, *Cyprus: Reunification or Partition?*, Europe Report N°201, 30 September 2009, p1 fn3

<sup>17</sup> European Commission website, *Turkish Cypriot community* (undated – viewed 4 November 2009)

<sup>18</sup> Council Regulation (EC) 866/2004 of 29 April 2004

<sup>19</sup> [http://ec.europa.eu/enlargement/turkish\\_cypriot\\_community/index\\_en.htm](http://ec.europa.eu/enlargement/turkish_cypriot_community/index_en.htm)

<sup>20</sup> See for example Commission Decision 2007/330/EC of 4 May 2007 determining conditions for trade in honey and fresh fish across the Green Line.

<sup>21</sup> See *Turkey Today*, Library Research Paper 08/90, 8 December 2008, pp75-76

<sup>22</sup> See David Hannay, "Cyprus: the costs of failure", *Centre for European Reform*, 1 September 2009 and International Crisis Group, *Cyprus: Reunification or Partition?*, Europe Report N°201, 30 September 2009, pp26-30

<sup>23</sup> See "Cyprus remains tough on Turkey's EU talks", *EU observer*, 21 July 2009

<sup>24</sup> European Commission, *Turkey 2009 Progress Report*, SEC(2009) 1334, 14 October 2009, p32



Security Council resolutions and in line with the principles on which the Union is founded. However, as underlined by the Council conclusions of 8 December 2008, and in line with the negotiating framework, Turkey is expected to support actively the ongoing negotiations and to take practical steps to contribute to creating a climate favourable to a fair, comprehensive and viable settlement of the Cyprus problem within the UN framework, in accordance with the relevant UN SC resolutions and in line with the principles on which the Union is founded.

The EU will continue to follow up and review progress made on issues covered by the Declaration of 21 September 2005, in accordance with the Council Conclusions of 11 December 2006.

Since the Council's decision of December 2006, Turkey has made no progress towards fully implementing the Additional Protocol to the Association Agreement and has kept its ports closed to vessels from the Republic of Cyprus despite several calls by the EU<sup>36</sup>. As pointed out by the December 2008 Council conclusions it is now urgent that Turkey fulfils its obligation to ensure full, non-discriminatory implementation of the Additional Protocol.

Turkey has made no progress on normalising bilateral relations with the Republic of Cyprus. It continues to veto Cyprus's membership of several international organisations and arrangements such as the Wassenaar Agreement on the Code of Conduct on Arms Exports and on Dual-Use Goods. Civilian vessels prospecting for oil on behalf of the Republic of Cyprus were hindered by the Turkish navy on several occasions during the reporting period.<sup>25</sup>

On the second point, Turkey's agreement to a settlement for Cyprus is particularly crucial in the area of security, as it has a substantial defence commitment to the 'TRNC' and any amendment of the 1960 Treaty of Guarantee would need the approval of the Turkish parliament.<sup>26</sup> If Turkey considers that Cyprus and other EU countries are unreasonably blocking its accession prospects, it is highly unlikely to compromise over Cyprus.

### **3 Economic situation<sup>27</sup>**

The economy of the Republic of Cyprus had been stable for some time, but as the global economic crisis has developed it has suffered a slowdown, with contraction now expected in 2009, and deteriorating public finances. The economy of the north continues to be seriously hampered by its political isolation, and there are some fears that without a settlement deal, the economies of both communities could be damaged.

#### **3.1 Republic of Cyprus**

The GDP of the Republic of Cyprus was \$25 billion in 2008, making it the 91<sup>st</sup> largest economy in the world. This is equivalent to just under 1% of the size the UK's economy or alternatively larger than Cameroon and smaller than Trinidad & Tobago.<sup>28</sup> However, GDP per capita was just over \$32,700 in 2008, making Cyprus the 26<sup>th</sup> richest on this measure.

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<sup>25</sup> European Commission, *Turkey 2009 Progress Report*, SEC(2009) 1334, 14 October 2009, p32

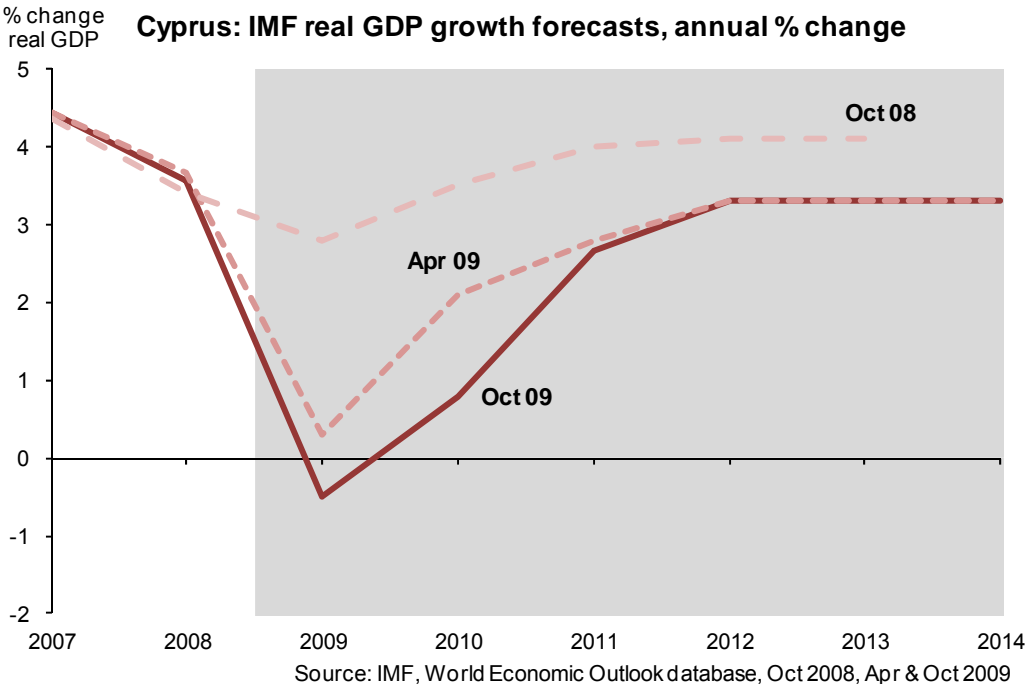
<sup>26</sup> International Crisis Group, *Cyprus: Reunification or Partition?*, Europe Report N°201, 30 September 2009, pp26-30

<sup>27</sup> By Ian Townsend, Economic Policy and Statistics Section. Data from IMF, *World Economic Outlook database*, October 2009, unless stated. Economic statistics for Cyprus do not include the 'TRNC'. The Republic of Cyprus' national accounts figures prepared by the Statistical Service of Cyprus (CYSTAT) cover economic activity in the government-controlled area of Cyprus only. Eurostat and IMF data (based on national data) similarly only cover the areas under the effective control of the government of the Republic of Cyprus.

<sup>28</sup> Using US dollars, based on market price exchange rates.

This is around three-quarters of the UK's per capita GDP of \$43,700, and puts Cyprus on a par with Spain and Greece.<sup>29</sup> Tourism is the most important sector in the Cypriot economy. In 2007, 2.4 million tourists visited the island; more than half were British.<sup>30</sup> UK exports to Cyprus were worth £525 million in 2008.<sup>31</sup>

Cyprus saw real economic growth averaging 3.8% over the ten years 1999 to 2008, with growth above 4% in six of those years. But amid the global financial and economic crisis, growth is expected to turn to contraction in 2009, with the Cypriot economy now expected to contract by 0.5%. This compares with a previous estimate issued in April 2009 for growth of 0.3%, itself a major downgrading of expectations for 2009 from 2.8% growth in forecasts made in October 2008 (see chart below).



The European Commission notes that the slowdown began in Q2 2008, and that the contraction of 0.7% it has forecast for 2009 would be the first year of negative growth in Cyprus for 30 years. It then expects slight growth of 0.1% in 2010 and then 1.3% in 2013.<sup>32</sup> However, on EC forecasts, Cyprus will have the smallest contraction of any countries in the eurozone (which it joined on 1 January 2008) in 2009, the next slowest being Greece (1.1% contraction), and a eurozone average of 4% contraction. Only Poland among EU member states is expected to grow in 2009 (1.2%).<sup>33</sup>

Consumer price inflation was steady at around 2% from 2004 to 2007, but increasing to 4.4% in 2008. However, it is now expected to fall to 0.4% in 2009 then 1.2% in 2010.

<sup>29</sup> Using US dollars, based on market price exchange rates.  
<sup>30</sup> [UK Trade and Investment](#), Cyprus profile page  
<sup>31</sup> [UK Trade Info](#)  
<sup>32</sup> European Commission, [European Economy Nov 2009; Cyprus forecasts](#)  
<sup>33</sup> European Commission, [European Economy Nov 2009; Cyprus forecasts](#)

The harmonised unemployment rate in September 2009 was 5.9%, which compares favourably with both the UK (7.8%, July figure) and the EU average (9.2%).<sup>34</sup> The IMF expects unemployment as a proportion of the total workforce to increase in 2009 and 2010.

Having run a government surplus in 2007 and 2008, this is expected to turn into a 4% deficit in 2009 and over 6% in 2010. Cyprus has run a current account deficit in each year since 1998. The deficit was equivalent to over 18% of GDP in 2008, and is projected to be 10% of GDP in 2009 and slightly less than 10% in 2010.

The European Commission has noted that global economic downturn:

[...] is expected to take a heavy toll on public finances: deficits exceeding 3% of GDP are projected over the forecast period, reflecting both lower tax elasticities and higher expenditure. As a result, the long-term sustainability prospects for public finances are deteriorating. The labour market is also expected to suffer, especially the labour-intensive sectors.<sup>35</sup>

In response to the crisis Cyprus implemented a small fiscal stimulus package equivalent to 1.5% of GDP, focused on construction and tourism, with targeted support for households.

### 3.2 'TRNC'

Since 1974 the economy of 'TRNC' has not made nearly as much progress as the Greek Cypriot area, though limited data makes any assessment difficult.<sup>36</sup> This is primarily because of the restrictions on external trade in goods and services as a result of its non-recognised status and also the legal uncertainty relating to property titles which has limited property development.

According to Europa World Online, this has led to a "dependency culture" in the north, as well as "corruption (including money-laundering) and poor economic governance."<sup>37</sup> However, from 2002 growth in the north accelerated, due to devaluation of the Turkish lira (the 'TRNC' currency) in 2001 and the opening of check-points on the Green Line in April 2003 (encouraging tourists from the south and boosting the incomes of Turkish Cypriots crossing the line to work). Until recently, the 'TRNC' had high inflation, largely 'imported' from Turkey because the 'TRNC' has no control over Turkey's monetary policy.

Although the official unemployment rate in the 'TRNC' is low, the actual unemployment rate is thought to be higher, although the 9.4% rate reported in 2006 was much higher than seen in previous years.<sup>38</sup> A construction boom on Greek-Cypriot-owned property after the collapse of the Annan Plan in 2004 also offered an economic boost, until legal threats brought this to an end.

The EU has a substantial aid programme for the Turkish Cypriot community. A €259 million EU aid package was agreed in February 2006, focusing on:

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<sup>34</sup> Eurostat database; [http://epp.eurostat.ec.europa.eu/cache/ITY\\_PUBLIC/3-30102009-AP/EN/3-30102009-AP-EN.PDF](http://epp.eurostat.ec.europa.eu/cache/ITY_PUBLIC/3-30102009-AP/EN/3-30102009-AP-EN.PDF)

<sup>35</sup> European Commission, *European Economy Nov 2009; Cyprus forecasts*, p107

<sup>36</sup> Some data are given on the website of the 'TRNC' Ministry of Foreign Affairs, but they are now very out of date. Economic statistics for Cyprus do not include the 'TRNC'. The Republic of Cyprus' national accounts figures prepared by the Statistical Service of Cyprus (CYSTAT) cover economic activity in the government-controlled area of Cyprus only. Eurostat and IMF data (based on national data) similarly only cover the areas under the effective control of the government of the Republic of Cyprus.

<sup>37</sup> Alan J Day & Fiona Mullen, "Economy (Cyprus)", *Europa World online* (retrieved 2 October 2009)

<sup>38</sup> Alan J Day & Fiona Mullen, "Economy (Cyprus)", *Europa World online* (retrieved 2 October 2009)

- social and economic development;
- infrastructure, in particular energy and transport, environment, telecommunications and water supply;
- reconciliation, confidence building measures, and support to civil society;
- bringing the Turkish Cypriot community closer to the Union, through information on the EU, and contacts between Turkish Cypriots and other EU citizens;
- helping the Turkish Cypriot community to be ready to implement EU rules (*acquis communautaire*) in case of a comprehensive settlement.

The package is being implemented by the European Commission's Enlargement Directorate over the five years 2006 to 2011.<sup>39</sup> As of the end of September 2009, the Commission had contracted €134 million (52%) of the overall programme (compared with around 30% awarded as at April 2009), and had endorsed €46 million for payment (18%), with the remainder expected to be signed by the end of 2009.<sup>40</sup> Further detail on implementation can be found on the [DG Enlargement](#) website.

A January 2009 written answer noted that implementation had "been slower than originally anticipated", but that "the benefits are already being felt", noting:

Ongoing projects include a successful programme of scholarships for Turkish Cypriot students and teachers to study and teach in EU universities, grant schemes for civil society and targeted support to farmers to upgrade their equipment. Full details are contained in the Commission's most recent annual report on the implementation of the financial aid package. We agree with their conclusion that the current settlement negotiations "will create a positive framework for facilitating the implementation and the success of this aid package" and look forward to rapid implementation of outstanding projects.<sup>41</sup>

A more recent written answer noted:

Tangible projects such as providing modern equipment to farmers, funding scholarships for students, improving traffic safety and replacing asbestos water pipes have already started and are making a real difference to the lives of ordinary Turkish Cypriots.<sup>42</sup>

According to an October 2009 written answer, citing a speech by Turkey's Prime Minister, Turkey gave the north an average of \$523 million a year between 2003 and 2009, and \$815 million of aid in 2009.<sup>43</sup>

## 4 Future prospects

The Economist Intelligence Unit puts the current likelihood of a Cyprus settlement at about two in five:

We put the chances of the Turkish and Greek Cypriots reaching a settlement to end the decades-old division of Cyprus in the outlook period at about 40%. A settlement is openly favoured by the current Cypriot leaders, the Greek Cypriot leader and president

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<sup>39</sup> Under Council Regulation no 89/2006

<sup>40</sup> [http://ec.europa.eu/enlargement/turkish\\_cypriot\\_community/aid\\_implementation\\_en.htm](http://ec.europa.eu/enlargement/turkish_cypriot_community/aid_implementation_en.htm) and HC Deb 20 October 2009 c1387W

<sup>41</sup> 12 HC Deb 12 January 2009 c366-7W

<sup>42</sup> HC Deb 20 October 2009 c1387W

<sup>43</sup> HC Deb 20 October 2009 c1388W

of the Republic of Cyprus, Demetris Christofias, and the Turkish Cypriot leader and president of the unrecognised Turkish Republic of Northern Cyprus (TRNC), Mehmet Ali Talat, and is supported by the Turkish and Greek governments, as well as in principle the Turkish military. However, more than a year into the process that started in April 2008 (full negotiations only began in September), considerable work remains to be done to bridge the many differences between the two sides. Therefore, even with the goodwill shown by all the interested parties, the risk is growing that time will run out before Mr Talat faces almost certain defeat to a more hardline opponent in the presidential election in April 2010.<sup>44</sup>

Many commentators agree that if the two current leaders cannot reach a solution, then no one will, and that “the window of opportunity for this bicomunal, bizonal settlement will close by April 2010, the date of the next Turkish Cypriot elections, when the pro-settlement leader risks losing his office to a more hardline candidate”.<sup>45</sup> For a settlement to be achieved before then, a referendum needs to be held in both communities in early 2010. This may still be possible: the International Crisis Group (ICG) considers that public and political support for a settlement are both strong, arguing that most Cypriots want the talks to succeed<sup>46</sup> and that rarely before have there been Greek Cypriot, Turkish Cypriot and Turkish leaders so ready to compromise. But whatever the outcome of the election, real progress in the reunification talks is likely to become increasingly difficult during the ‘TRNC’ presidential election campaign period.

David Hannay is less apocalyptic, but nevertheless sees a different end-point for the negotiations:

It is not inconceivable that this particular phase of negotiations may hit the buffers, or, perhaps more likely, get bogged down in irreconcilable differences, without that representing the end of all hopes for re-uniting the island. So long as there is breath in the body of Turkey’s EU accession aspirations, there will be some hope for a Cyprus settlement. And even on the most optimistic assessment, those accession negotiations have quite a few years to run. So I would link the ‘last chance’ scenario to the fate of Turkey’s EU bid, not to this particular phase of the Cyprus negotiations saga. However, the two things could come to be elided in some circumstances, such as a firming up of the opposition to Turkish membership in France, Germany or Austria, so as to prevent the continuation of the country’s accession negotiations; or a Turkish decision to pull out of these negotiations.<sup>47</sup>

The UN Secretary General’s May 2009 report on Cyprus<sup>48</sup> welcomed the two leaders’ constructive and open approach to the negotiations, but warned that “while areas of significant divergence may be fewer, most are nonetheless fundamental, reflecting the challenge of translating the agreed objective of a bizonal, bicomunal federation with political equality into a functional united Cyprus, where legitimate interests are not only represented but also effectively pursued”. He considered that the status quo was unacceptable and that a settlement would become harder to reach as each day passes without a solution. Opinion polls were, he said, showing a high level of scepticism among the respective populations towards the ongoing negotiations – a real threat to a settlement given

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<sup>44</sup> “Business outlook: Cyprus”, *EIU – Business Europe*, 16 September 2009, p9

<sup>45</sup> International Crisis Group, *Cyprus: Reunification or Partition?*, Europe Report N°201, 30 September 2009

<sup>46</sup> See Alexandros Lordos, Erol Kaymak and Nathalie Tocci, “A people’s peace in Cyprus: Testing public opinion on the options for a comprehensive settlement”, *Centre for European Policy Studies*, April 2009

<sup>47</sup> David Hannay, “Cyprus: the costs of failure”, *Centre for European Reform*, 1 September 2009

<sup>48</sup> UN Security Council, *Report of the Secretary-General on the United Nations operation in Cyprus*, S/2009/248, 15 May 2009,

that any eventual agreement will require popular support expressed through simultaneous referendums.<sup>49</sup> He concluded that:

to help bring the negotiations to a successful conclusion, the need to rationalize the process to deliver results becomes more pressing. The recent increase in the number of meetings at the level of representatives and experts, as a dedicated structure in support of the leaders, as well as the commitment of the leaders in early May to intensify this level of the talks, has been encouraging. As the leaders conclude the first reading, it will be necessary for them to give shape to the broader outline of an agreement which will naturally emerge. The representatives could play a useful role in taking this idea forward in a dynamic and interactive manner.<sup>50</sup>

There may be a boost to the Cyprus negotiations from return to office in Greece of the socialist party, PASOK, under its leader George Papandreou, in the 4 October 2009 elections. Prime Minister Papandreou, who is also serving as Foreign Minister, describes himself as a “diaspora Greek”, and was largely responsible for the rapprochement between Athens and Ankara in the 1990s.<sup>51</sup> He has pledged that Greece’s foreign policy will be given a complete overhaul. His first trip abroad following the elections was to Turkey, in his capacity as Foreign Minister, and his first trip as Prime Minister was to Cyprus. Whilst the Greek policy of supporting the negotiating position of the Republic of Cyprus will not change, Greece is likely to take a more interventionist approach on the issue than before.

Europa World Online offers the following politico-economic outlook for Cyprus should rapprochement fail:

In the absence of a political solution, the two economies are expected to diverge even further, with the Turkish Cypriot economy increasing its dependence on Turkey, with few incentives for structural reform, and the Greek Cypriot economy becoming more closely integrated with the EU. In the longer term, and in order to respond to the competitiveness challenges of being in the euro area, the Republic of Cyprus Government is seeking to promote higher value-added tourism, and investment in research and development, especially in the areas of environment and water, while continuing to promote Cyprus as a regional financial centre.<sup>52</sup>

One important potential source of future economic growth is the possible existence of major petroleum and gas deposits in the eastern Mediterranean, south of Cyprus and within its 200-mile exclusive economic zone. However, exploitation of these finds appears to be awaiting a settlement of the Cyprus problem.<sup>53</sup>

The ICG fears that in the absence of a settlement, both communities on the island – as well as Turkey – would lose out, experiencing slower economic progress, greater defence spending and reduced international credibility.<sup>54</sup> Moreover, the future prospects for a settlement are likely to recede year by year, as more development takes place in the north and there are more Turkish settlers, and as the status quo becomes yet more entrenched and an increasing proportion of the adult population has never known a unified Cyprus. Without a settlement, Cyprus is thought likely to slide into an indefinite hostile partition, which commentators warn would lead to further strains in EU-Turkey relations, new frictions in the

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<sup>49</sup> pp9-10

<sup>50</sup> p11

<sup>51</sup> “Greeks set to vote for change”, *European Voice*, 1 October 2009, p4

<sup>52</sup> Alan J Day & Fiona Mullen, “[Economy \(Cyprus\)](#)”, *Europa World online* (retrieved 2 October 2009)

<sup>53</sup> *Ibid*

<sup>54</sup> International Crisis Group, [Cyprus: Reunification or Partition?](#), Europe Report N°201, 30 September 2009

east Mediterranean, damage to EU-NATO cooperation, acceleration of the centrifugal forces scattering the Turkish Cypriots and new risks to the prosperity and security of Greek Cypriots.<sup>55</sup> There may also be security concerns if the UN peace-keeping force, UNFICYP, is withdrawn: when the Security Council debated an extension of UNFICYP's mandate in May 2009, some countries questioned the rationale for the mission if the negotiations should fail.<sup>56</sup>

David Hannay suggests that "the benefits of success would not only comprise an economically thriving Cyprus but also wider regional stability and improved prospects for a successful conclusion of Turkey's EU accession process."<sup>57</sup> But despite the changed circumstances and undoubted progress in the last 18 months, it seems that neither the disadvantages of continued partition nor the advantages of a peaceful solution yet provide enough of an incentive to overcome the very real difficulties that are still besetting the settlement negotiations.

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<sup>55</sup> International Crisis Group, *Cyprus: Reunification or Partition?*, Europe Report N°201, 30 September 2009

<sup>56</sup> Sven Gunnar Simonsen, "Best Chance, Last Chance", *The World Today*, vol65 no11, November 2009, p26

<sup>57</sup> David Hannay, "Cyprus: the costs of failure", *Centre for European Reform*, 1 September 2009