

Northern Cyprus Competitiveness Report

2021 - 2022
Special Edition

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Preface

Dear Reader,

As the Turkish Cypriot Chamber of Commerce, we are proud to publish the thirteenth of the Northern Cyprus Competitiveness Report this year.

We all know that economic activities stopped due to the Covid-19 pandemic, which also affected our island in March 2020. It caused great negativities in the TRNC, which has an economy based on foreign demand.

Unfortunately, while trying to get rid of the effect of the pandemic, we were caught in a new storm caused by the rise in the exchange rates and inflationary developments in the world. The rise in exchange rates and supply problems, combined with the rise in international commodity prices and container freight costs, further increased the inflation pressure and the contraction in business volumes reduced the resilience of the private sector against the crisis.

These developments affect businesses negatively, turnover decreases and costs increase. Every business takes measures to protect its turnover in such cases and starts to sacrifice its profits, but after a while, this measure becomes insufficient and businesses begin to close or shrink; employment decreases, and people become unemployed.

In this process, measures should be taken to trigger growth by implementing support and loan programs to prevent unemployment, protect employment and ensure the continuity of economic activities.

In this context, the current social insurance support for the protection of employment and the prevention of unemployment should be revised, and the support rate should be increased to 100% until the end of 2022, especially for the sectors directly affected by the crisis, and to at least 75% for the others. Regardless of the sector;

a loan package with interest support and a grace period should be prepared to finance the activities of

enterprises to solve their working capital problems and to protect the continuity of their economic activities. The rise in international freight prices brings a negative cost increase to the selling prices of the products in the market. In line with the target of cheapening the market, all taxes and duties charged at customs for a certain period of time should be calculated over the FOB value.

These are just some of the precautions that can be taken. Our Chamber emphasizes the importance of reforms, especially public reform, on every occasion. In this process, reforms should be prioritized and implemented in order to ensure an inclusive and strong economic recovery. These reforms should increase the efficiency of public services and bring working hours into conformity with the private sector; facilitate access to public health and education services; protect registered businesses against inflation by adopting inflation accounting while reducing informality; ensure that the incentives reach their target while protecting public resources by rearranging the incentive system, and reduce transportation costs with a new public transportation system.

This year's theme in our Competitiveness Report is the foreign market competitiveness and export opportunities of the TRNC agricultural sector. Food shortages, breakage in the supply chain and excessive prices due to climate change, which emerged during and after the pandemic process, show the importance of agricultural production. In addition, it is obvious that the water coming from Turkey will open a new page for the TRNC agricultural sector.

With this year's theme, besides the existing agricultural

products, new strategies for high value-added and advantageous agricultural products are determined, and opinions and suggestions are presented on the foreign market competitiveness of the agricultural sector.

Prof. Dr. Mustafa Besim, Assoc. Prof. Dr. Kamil Sertođlu and Assist. Prof. Dr. Yenal Süreç had written our report this year. I would like to thank them and everyone who contributed.

The Turkish Cypriot Chamber of Commerce will continue to be a follower of the issues raised and contribute to the formation of social dialogue channels.

Best regards,

Turgay Deniz,
President of the Turkish Cypriot Chamber of Commerce

Executive Summary

Economic Situation in the World and in Northern Cyprus

The US-based global financial crisis in 2009, the COVID-19 pandemic that originated in China at the end of 2019 and has engulfed the whole world, and the Russia-Ukraine war that started in February 2022 show that the world is nothing but a large village. Local and regional problems can turn into global ones extremely quickly. Unfortunately, the Russia-Ukraine war will greatly strain the global food system already weakened by COVID-19, climate change, and energy shocks. At the current stage, high inflation and the risk of contraction in the economy are the leading economic problems experienced cyclically at the global level. In other words, with the outbreak of the war, the risk of experiencing stagflation has increased tremendously.

The TRNC, which is in a monetary union with Turkey, is directly affected by the monetary policies implemented by the Central Bank of the Republic of Turkey (CBRT). The fact that production opportunities are limited in Northern Cyprus, the markets are not as deep, and they are highly dependent on imports of goods. In addition, there is high exchange-rate pass-through in prices. Increases in indirect taxes to cover the budget deficits caused by the structural problems in public finances, coupled with the stated problems caused the annual inflation rate to reach 98% by the end of May 2022 in Northern Cyprus. The ongoing risks at the global level and the TRNC's lack of a policy to combat inflation in its own right indicate that the inflation problem in the country will persist.

The events of the last quarter of century indicate that the future will not be very stable and without crisis. Rising global warming, epidemic problems, and economic interdependence brought about by globalization have made world economies more fragile. That is why all countries must address global issues and work together to find solutions to the world's most pressing problems, including the ongoing global epidemic, the war in Ukraine, geo-economic shocks, and climate change. While doing this, they must make sure that the policies they will develop in the new world order will bring permanent solutions to said environmental, epidemic, and economic shock problems.

The TRNC entered the pandemic with a both cyclically and structurally weak economic structure. The low rate of economic growth experienced in 2018-19, the exchange rate and inflation problems stemming from the Turkish lira (TL) and the increasing risks in the money markets in the same period rendered the TRNC economy unprepared for the pandemic. In addition to the economic and structural problems, governmental stability has not been achieved since the beginning of the pandemic. The fact that governments could not take effective, consistent, and conclusive decisions against the current pandemic also caused the crisis to deepen. In addition, the inability to receive timely and complete financial support from Turkey due to the failure of governments to implement reforms, which is part of the budget, has created difficulties in the finances, causing the Ministry of Finance to increase its domestic borrowing and indirect tax increases to fulfil its minimum obligations.

To assess the latest developments in the country's economy from the point of view of businesses, a phone survey was conducted with the members of the Turkish Cypriot Chamber of Commerce (KTTO). Of the 201 KTTO members who responded to the survey, 41.8% are from Nicosia / Lefkoşa, 22.9% from Famagusta/Gazimağusa, 19.4% from Kyrenia/Girne, 6.5% from Trikomo/Iskele, 5.5% from Morphou/Güzelyurt and 4% from Lefke. Although sales in TL have increased for 134 (66%) respondent businesses, 36.8% of the businesses stated that they continued to operate with a declining rate in their business activities, 45.27% said their business operations continued at the same level, and only 17.9% stated that they experienced an increase in their business activities. Respectively, 83.3% of the businesses responding to the survey stated that the tax burden had increased and 74.54% stated that the employment cost had increased. Worse still, 88% of the respondent businesses expect that the tax burden will increase anywhere from 25% to 100% in 2022. Out of the businesses that borrowed loans, 45.45% used the loans to pay their existing debt, 39.77% for working capital, and only 14.77% used the loans for investment. This shows that businesses have faced liquidity problems due to their shrinking operations during the pandemic period, had difficulties in fulfilling their obligations, and obtained loans only to continue their existing activities

and survive. 50.75% of businesses think that the economy will start to improve, 36.18% of them think that it will continue to fare badly, and 12.56% of them think that the economy will get worse. In total, those who say it will be good and bad are almost equal in proportion. This finding can be interpreted as the impact of continued recession in the economy for the last 2 years and the lack of recovery since the beginning of 2022. The primary expectations of the businesses from the government are to reduce indirect tax rates to ease the tax burden, achieve stability and take counter-inflation measures to fight against inflation.

The government should develop prioritized economic policies for the main problems experienced in the TRNC. The government must set out a clear and understandable policy measures to combat inflation. Fiscal policy should be set out in a more detailed and precise manner by devising short-, mid-, and long-term plans. In particular, tax and budgetary policies should be clearly stated, and businesses should know how much tax they will be paying in the coming months. On the expenditure side, the envisaged supplementary budget should be aimed at alleviating the problems caused by inflation in the first 5 months of 2022. Effective policies should be developed for low- and middle-income groups, which are most affected by the instability and inflation, and these groups should be supported. The effects of the increase in indirect taxes which are mainly introduced to finance budget deficits should be appraised properly from the point of inflation and the market in general before they are introduced.

Transformation Readiness

The Global Competitiveness Report, which has been regularly published by the World Economic Forum for nearly two decades, was interrupted for the first time due to Covid 19 pandemic. The work, which was suspended due to the extraordinary conditions during the pandemic and the uncertainty, came up with a special edition last year. TCCC who had not published any report last year, came up with a special edition this year. In addition to the uncertainties brought about by the pandemic, factors such as changing social needs and consumption patterns and increased use of technology have led the World Economy Form to a special study based on the assessment of the transformation capacity of selected countries. In this special edition, the capacity of governments to take urgent measures against the pandemic and related economic shocks, as well as other unexpected shocks that can affect millions of people and businesses around the world, and their capacity

for "transformation readiness" in the medium and long term are scored.

In the special edition, the World Economic Forum examines how ready countries are for the change in question from various aspects. Policy recommendations that will enable transformation for countries are gathered in four areas of action. The first of these is the policy area of *"reviving and transforming the enabling environment"*, where institutions and physical infrastructure are examined in terms of ensuring physical (environmental) and institutional sustainability. In this context, physical infrastructure capacities such as transportation, communication and energy, and fiscal and monetary policy implementation capacities of governments, in other words, governance capacities in general, are discussed. The second policy priority area is *"reviving and transforming human capital"*, which investigates the adaptability of human capital, the main component of production, to newly developing needs. With the developing technology and novel production models, different skill needs arise. Considering the new skill demands in the labour market, firstly education systems and curricula and the healthcare delivery for the workforce need to be transformed in response to arising needs. The third area is *"reviving and transforming markets"*, focusing on the transforming the markets to tomorrow and enabling efficient allocation of resources. The recommendation here is to prevent newly developing digital businesses and platforms from dominating the markets completely and increase consumer welfare by ensuring fair access to resources. The fourth policy priority area is *"reviving and transforming the innovation ecosystem"*. In this area, it is recommended that governments should develop policies to support R&D investments, innovations, and inventions in more public-private partnerships and incentivize firms to embrace diversity, equity and inclusion to enhance creativity.

While 130 to 140 countries were included in the competitiveness reports in previous years, only 37 countries, most of which are OECD members, were included in 2021-2022 special edition. One of the reasons for this is that many of the indicators used in the special edition's calculations are not available in most of the countries not included in the study. Similarly, unlike in previous years, countries were not ranked in any order after their transformation readiness scores were calculated. In analyses regarding each country's score, their strengths and weaknesses for transformation are noted, and policy recommendations are made for the short and long term. However, one of the most striking results of the study

is that no country is ready for transformation. However, each country in the study has certain areas in which they are doing well. Based on the existing indicators and the perception from the executive surveys, it can be argued that Northern Cyprus is performing better, albeit not sufficiently, in judicial independence, work life, and health spending than in other areas.

Foreign Market Competitiveness and Export Opportunities of TRNC Agricultural Sector

As is the case for many small economies, the driving engine of the economy in Northern Cyprus is the services sector. Sectors such as agriculture are complementary to services and are vital to prevent the money coming into the country through services from seeping out in various ways. Traditionally, the agricultural sector has been one of the most important economic activities of Turkish Cypriots. Today, agriculture has become important all over the world. Both the food shortage that occurred during and after the pandemic, and the extreme prices due to the ruptures in the supply chains and climate change show that agricultural production has become more sensitive to regional and global problems. In light of these facts, the theme of this year's special edition is devoted to the agricultural sector of Northern Cyprus.

It is obvious that a new page has been turned with the water coming from Turkey for agricultural products, which constitute the main vein of the limited export potential of Northern Cyprus. Hence, it is important that new strategies be devised for agriculture and the water that will be coming in be used in new areas with high added value that are going to make use of the advantages in the agricultural sector. Considering the existing conditions of the country, production costs, capacity, and other factors, it is necessary for the TRNC to direct its limited export potential to areas with the highest added value possible. Considering the export markets close to the country, niche and organic produce come first among these areas. It is thought that the export potential is high especially in fresh fruits and vegetables. It is especially important to gain access to markets with high income levels, but with equally high entry standards, such as the European Union and the UK.

As the World Economic Forum states in this year's special edition, "transformation" is a must for economies. While transformation should start in every area for Northern Cyprus, it is unthinkable that the agricultural sector should be left out of this. Continuing to use the water coming from Turkey in the same crop patterns by insisting on current agricultural

policies would mean not being able to realize the potential in Northern Cyprus that comes about with the water and hence ignoring the opportunities in foreign trade. In this context, the relevant ministry should put crop alteration at the core of its policies and direct the country's production factors towards the production of crops where foreign trade will be maximized.

The pandemic that affected the whole world in 2020 as well as the post-pandemic developments show that the agricultural sector, as all others, has evolved. In addition to the problems caused by the pandemic, the Russia-Ukraine war and the related supply shocks of 2022 severely disrupted the functioning of the global agricultural market. Today, an extraordinary uncertainty prevails in basic agricultural products and inputs, especially in terms of accessibility and affordability. This increases the risk perception of the players in the sector excessively. **At the moment we are going through a time when the pricing behaviour, which is the most important element of the free market economy, has completely deteriorated. As a result of all these developments, the largest price increases in recent memory have been observed in global agricultural markets and the world today is faced with a massive food crisis. It is obvious that all these developments will have enormous economic, social, and humanitarian impacts. The extent of the damage we will experience in this process will be determined by the governments that direct the country's economy.**

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INTRODUCTION

Globalization, Economic Interdependence, and Fragility

Northern Cyprus Amidst Increased Global Vulnerability

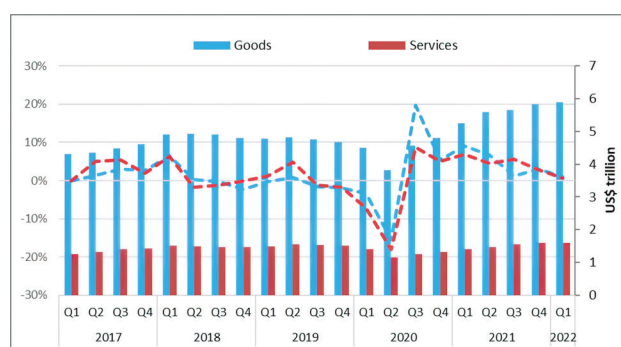
Economic Assessment Survey

Priority Economic Policies

Globalization, Economic Interdependence, and Fragility

In the last century, inter-economic trade, economic cooperation, and financial interaction have increased tremendously. This phenomenon of globalization has greatly helped the economic development of countries, improved their living standards, and increased their quality of life. This global interaction has been led by bilateral agreements between countries as well as international organizations such as the United Nations (UN), the International Monetary Fund (IMF), the World Bank, the World Trade Organization, and regional formations like the European Union and the North American Free Trade Agreement (NAFTA). According to the United Nations Conference on Trade and Development (UNCTAD), world trade in goods and services reached \$28.5 trillion by the end of 2021.

Figure 1.1 World Trade in Goods and Services (2017-2022)



Source: UN UNCTAD 2022

Again, in the same period, both the deregulations made in the capital account as well as the developments in technology and communication means, increased the global capital flow, reaching to \$77.5 billion in the second half of 2021. Although globalization has not benefited the development of all economies equally, it has increased the interdependence of countries. This interdependency has meant that the economic developments taking place and decisions made in big economies in the world such as the US, China, Japan, and Germany have an impact on all world economies. Especially those developing economies which finance their economic growth by exporting goods and services abroad and receiving capital inflows are affected relatively more by the developments in the afore-mentioned large economies. The US-based global financial crisis in 2009, the COVID-19 pandemic that originated in China at the end of 2019 and has engulfed the whole world, and the Russia-Ukraine war that started in February 2022 show that the world is just a large village. Due to the high degree of economic interdependency, local and regional problems

can quickly turn into global problems, and countries that have nothing to do with the source of the problem can suffer severely from it. The Russia-Ukraine war is of such a scale that it has destructive impacts on the lives of people far from that region.

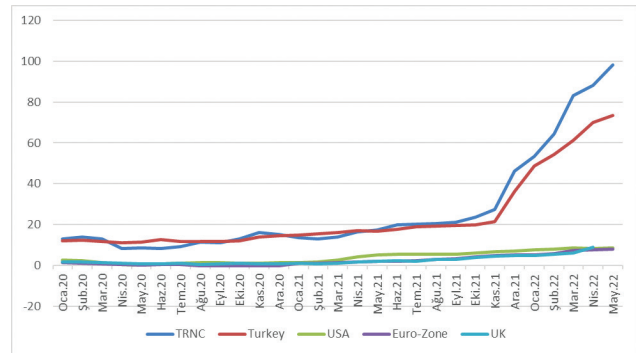
The Russia-Ukraine war will greatly strain the global food system already weakened by COVID-19, climate change, and energy shocks. Since Russia and Ukraine provide 12% of the world's grain and seed (calories) production and this trade has largely stopped, grain prices have increased by 53% since the beginning of the year. In addition, the poor weather conditions in India and the Indian government's announcement that it would suspend its exports to the world caused grain prices to increase by 6% in May. UN Secretary-General António Guterres remarked on 18 May that the coming months might threaten to cause years of global food shortages and that the number of people who are not sure whether they can access food due to the high cost of basic foodstuff has increased from 440 million up to 1.6 billion.

Undoubtedly, globalization has provided significant growth resources and income generation opportunities especially for emerging and developing economies. However, in countries where necessary precautions and measures have not been taken, decisive steps have not been taken to boost competitiveness, insufficient savings, weak public finances, low working capital, and minimum food production and basic health services failing, will be paying the most cost in this process. Fragile and uncompetitive economies will not be able to withstand external shocks; they have been affected more by the global crisis and will be affected more in the coming months due to their vulnerability to overcome the crises.

High inflation and the risk of contraction in the economy are the leading economic problems experienced cyclically at the global level. In other words, with the outbreak of the war, the risk of experiencing stagflation has increased tremendously. Excess demand created by the expansionary monetary and fiscal policies put in place to combat COVID-19 during the recovery period is an important factor for inflation. In addition, the problems experienced in the supply of goods and services, especially the issues in the supply chain, are the second main reason for inflation. The increase in commodity prices such as natural gas and grain, propelled by the Russia-Ukraine war, caused inflation to reach the highest level of the last 40 years. While annual inflation in the US reached 8.6% in May, a 8.1% annual price increase was experienced in the eurozone and 9% in the UK. It is stated that nearly three quarters of

eurozone inflation can be explained by rapidly rising energy and food prices.

Figure 1.2 Inflation (CPI, January 2020-May 2022, %)



Source: TRNC Statistical Institute, Turkish Statistical Institute, Eurostat, OECD

In the same period, inflation reached much higher levels in Turkey, reaching 73.5% by the end of May 2022. As can be seen from the figure that describes the inflation, while the inflation in Turkey was around 10% in the months when the pandemic period started, it started to rise due to recovery in aggregate demand as of March 2021, in parallel with the economic recovery on the global level. After the summer of 2021, inflation in Turkey has reached a difference of more than 60% compared to inflation in the USA and Europe.

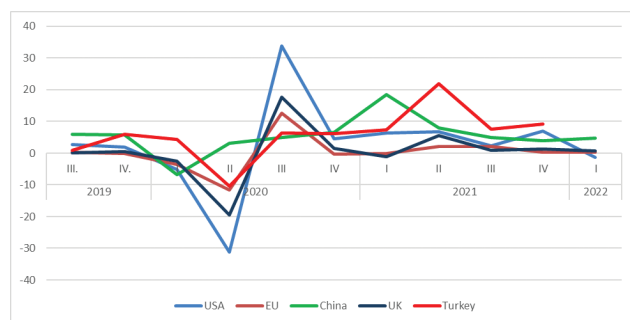
The TRNC, which is in a monetary union with Turkey, is directly affected by the monetary policies implemented by the Central Bank of the Republic of Turkey (CBRT). Mired with limited production possibilities, somewhat shallow markets, dependence on goods imports and due to high exchange-rate pass-through, TRNC experience high inflation. Due to foreign trade being conducted in foreign currency as well as housing, automotive and energy prices being set in foreign currency, together with the country's own structural problems, the inflation reached 98% annually in May 2022. Indirect taxes (price stability fund) increases used to meet the deficits resulting from the structural problems in public finances also cause inflation. The ongoing risks at the global level and the TRNC's lack of a solid policy to combat inflation in its own right indicate that the inflation problem in the country will persist.

The COVID-19 pandemic impacted all economies negatively. As can be seen in figure 1.3 representing the period from the third quarter of 2019 to the first quarter of 2022, economic contraction started in the leading economies of the world, including the US, China, the EU, Great Britain, and Turkey, in the first quarter of 2020 and high rates of economic recession were experienced in all countries except for China in the

second half of 2020. This recession was as high as 31% in the US and 19% in Great Britain. Expansionary monetary and fiscal policies implemented quickly by the leading economies yielded positive results in the second half of 2020, and world economies entered a recovery process. However, because countries had not experienced such a pandemic before and the process heavily damaged production lines and supply and demand channels, although recovery has taken place, attaining stability is not easy to achieve. Indeed, high demand and insufficient supply caused disruptions in the supply chain and led to some countries experiencing problems in generating income and therefore economic growth. Especially EU countries and Britain experienced a contraction in the economy in the first quarter of 2021. In addition, inflation and other phenomena that cause instability have emerged.

Beyond that, the pandemic has caused significant losses

Figure 1.3 Economic Growth
(Selected Countries, 2019 Q3 to 2022 Q1, %)



Source: Turkish Statistical Institute, Eurostat, OECD

to businesses, especially in the fields of tourism, aviation, automotive, and housing-construction. On the other hand, businesses engaged in electronic trade, information technologies, personal care and healthcare, food production and sale, and health products and service provision have been the most profitable during this period. If this micro assessment were scaled up to the macro level of countries, it could be seen that economies based on tourism, housing, and services were the greatest losers of the pandemic. The experience of the pandemic has caused changes in the production patterns of economies, and the use of technology has led to the emergence of different consumption behaviours. Especially countries with flexible economies and high competitiveness started to adapt to this process early. However, in economies where there is no flexibility in the production and labour market, this caused a significant loss of production and increased unemployment. Finally, due to the Russia-Ukraine war that broke out in February 2022, the world economy is having

difficulties in recovering on the global level and it appears that instability will persist. In addition to the problem of stagflation, risks in food supply will cause scarcity.

The events of the last quarter century indicate that the future will not be very stable and crisis-free. Rising global warming, epidemic problems, and economic dependency brought about by globalization have made world economies more fragile. During this time, when expectations from the future are not clear, it will be difficult for businesses to make correct and rational decisions. With increasing risks, businesses have difficulty in making investment plans. It is clear that the aforementioned issues cannot be resolved through the decisions countries will take on their own. That is why all countries must address global issues and work to find solutions to the world's most pressing problems, including the ongoing global epidemic, the war in Ukraine, geo-economic shocks, and climate change together. While doing this, countries must make sure that the policies they develop in the new world order will bring permanent solutions to said environmental, epidemic, and economic shock problems. While countries develop the capabilities to adapt easily to changing conditions in the medium and long term, they will also need to build the necessary capacities for transformation.

Northern Cyprus Amidst Increased Global Vulnerability

The TRNC entered the pandemic with a both cyclically and structurally weak economic structure. The low rate of economic growth experienced in 2018-19, the exchange rate and inflation problems and the increasing risks in the money markets in the same period caused the TRNC economy to be caught unprepared. Structural problems such as ongoing budgetary problems, low doing business, and physical and legal infrastructure deficiencies caused the pandemic to have a strong impact. According to the official data, the TRNC economy shrank by 16.2% in 2020, and the GDP per capita fell to \$10 thousand. According to the household labour force survey, nearly 12,000 people have been laid off in the total workforce, while the social insurance data shows that registered workers went down from 119,568 to 105,945 in 2021. While the number of closed workplaces was 116 in March 2020, this figure rose to 125 per month in June. As a result of the contraction in demand in the TRNC, the imports regressed by \$300 million in 2020 compared to 2019 and it is believed that it will not reach \$1.8 billion, which was its level in 2018, in 2021. With the shrinkage in aggregate demand, the

increase in revenues in public finances lagged the increase in expenditures, and the local deficit in 2020 reached 1 billion 243 million and 1 billion 489 million TL in 2021. Due to the fiscal difficulties, expansionary fiscal policies were not implemented, and instead financial sector resources and limited social security funds were used to extricate TRNC economy from the crisis. The economy was supported during this period by as much as 1.5 billion TL generated mainly from the financial sector. These financial means were mainly to support working capital of businesses, restructuring/deferral of loans, and providing social security premium supports.

Although the national income figures for 2021 have not been announced, labour force and imports data show that the economy will only grow at a very low rate and will achieve only a slight recovery. It seems that few years will be needed to compensate for the contraction experienced in 2020. The increase in the exchange rates significantly affected the TRNC economy, which is dependent on imports and whose prices are determined based on foreign currency, and caused a contraction in the total demand, which was trying to recover with the excessively rising inflation. The fiscally weak TRNC could not respond to this external shock originating from TL in a timely and effective manner. This increased uncertainty for consumers and investors alike.

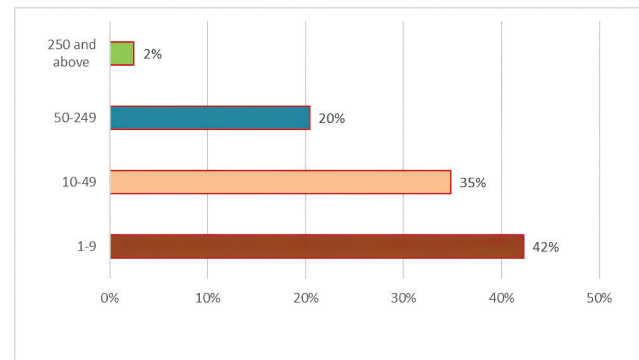
In addition to the economic and structural problems, political instability since the beginning of the pandemic has also contributed to prolonged recovery. The fact that governments could not take effective, consistent, and conclusive decisions against the current pandemic have also caused the crisis to deepen. In addition, delayed and incomplete financial support from Turkey due to the failure of governments to implement reforms, which was budgeted, has created difficulties in public finances. This forced the government to look for alternative means of financing such as rising indirect taxes and increase its domestic borrowing to fulfil its minimum obligations.

Economic Assessment Survey

To assess the latest developments in the country's economy from the point of view of businesses, a phone survey was conducted with the members of the Turkish Cypriot Chamber of Commerce (KTTO) on April 2022. In this Economic Assessment Survey, businesses were asked questions about their activities for the past one year and their expectations about the future. It is expected that this survey will be a complementary work to analysis made with the available

macroeconomic data. In this way, published data were supported with information from the economy and up-to-date data on the economy were obtained from businesses. Of the 201 KTTO members who responded to the survey, 41.8% are from Nicosia, 22.9% from Famagusta/Gazimağusa, 19.4% from Kyrenia/Girne, 6.5% from Trikomo/Iskele, 5.5% from Morphou/Güzelyurt and 4% from Lefke.

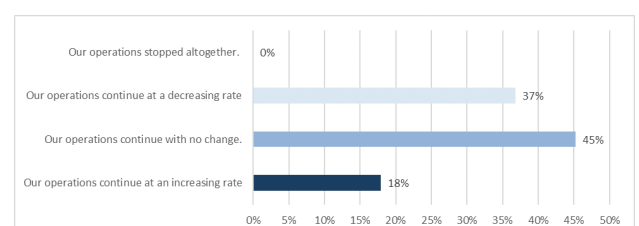
Figure 1.4 Employment in businesses"



The fields of activity of the companies were sampled in such a way as to cover all sectors of the economy, from transportation to accommodation, financial insurance and banking to culture, arts, and entertainment, as well as areas such as trade, manufacturing, food services, information and telecommunication services, construction, and real estate. 42.29% of the businesses employ one to nine people, 34.83% 10 to 49 people, 20.40% 50 to 249 people and 2.49% 250 people or more. As for the turnovers of the companies last year, 47% did not exceed 3 million, 32.16% 25 million, and 20.10% up to 125 million.

Although sales in TL have increased for 134 (66%) businesses in the last year, 36.8% of the businesses stated that they continued to operate at a decreasing rate with their business activities. 45.27% of the businesses continued their operations in the same level, and only 17.9% stated that they saw a rise in their business activities. This shows that businesses have not been fully recovered yet. The instability caused by the fluctuation in the exchange rate starting at the end of last summer seems to have prevented the recovery.

Figure 1.5 Operations of the businesses in the past year



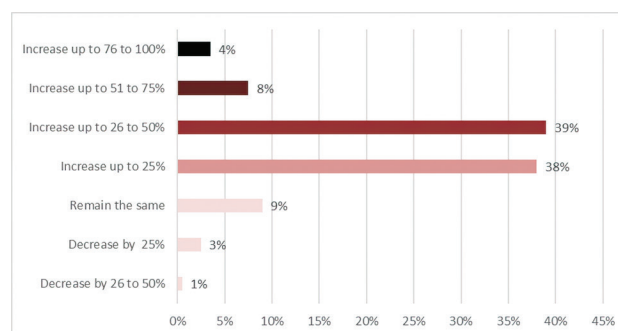
In the same period, 66.7% of the businesses did not change their workforce where only 17.69% of the companies had to reduce their workforce. While for orders 41.21% of the businesses remained the same compared to the previous year. There was an increase in orders only in 27% of the business. This finding as well as the responses related to the operations in the past year show that the businesses have not fully recovered the decline they have experienced since the beginning of the pandemic and still have not reached a pre-2020 level of activity.

The fact that there has been significant increases in indirect taxes, governmental fees and charges despite a stagnation in the revenues and activities of the businesses, has increased both tax and employment cost burden on the businesses. Respectively, 83.3% of the businesses responding to the survey stated that the tax burden has increased. At the same time, 74.5% of businesses indicated that employment cost burden had increased in the last year. This shows that the government's social security premium support and other assistance to the labour market have not been sufficient and have not reached to their targets.

In response to the questions about the future, 73.5% of the businesses stated that they expected to see their sales go up and close to 80% said the number of employees they have would not change. This shows that businesses actually expect to recover in 2022. On the other hand, there is an expectation that the increase in the tax burden that the businesses shouldered in the past year will persist in 2022 too. 88% of the respondent businesses expect that the tax burden will increase anywhere from 25% to 100% in 2022. This negative expectation is related to the anticipation that the 2022 budget deficit is very high and that the government will attempt to close that deficit by increasing taxes and governmental fees and charges. In addition, the following expectations might cause the businesses to think they will face additional tax burden: lack of clarity as to whether the economy will recover or not; the increase in exchange rates, impacting the TRNC economy directly and the inflation it would in turn cause; and the Russia-Ukraine war and related global risks.

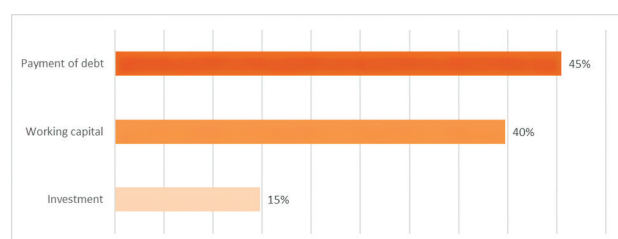
42.5% of the companies surveyed used loans in the last two years, and two-thirds of those that did not use loans stated that they did not borrow because their own capital was sufficient. The fact that the businesses have sufficient capital can be considered as a good indicator. However, 21% stated that they did not use loans due to high interests and 8.26%

Figure 1.6 2022 tax burden expectation of businesses



due to heavy collateral conditions. Out of the businesses that borrowed loans, 45.5% used the loans to pay their existing debt, 39.7% for capitalization, and only 14.7% used the loans for investment. This shows that businesses have faced liquidity problems due to their shrinking operations during the pandemic period, had difficulties in fulfilling their obligations, and obtained loans only to be able to continue their existing operations and survive.

Figure 1.7 Purpose of businesses loans



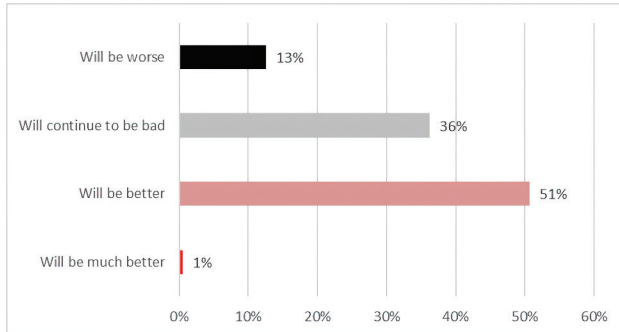
More than half of the businesses (54.7%) stated that they do not need loans in the near future, and nearly 60% of those that do need loans stated that they wished to use loans of up to 1 million TL for working capital.

The three risks foreseen by businesses in 2022 are volatility in exchange rates (66%), high tax rates (51%), and inflation (46%). These risks are actually the main sources of the instability experienced in the past 2 years. Excessive fluctuations in exchange rates not only increase the input costs of the businesses, but also cause them to have difficulty in replacing what they sell and have trouble setting prices. High inflation causes instability and a decline in purchasing power, which leads consumers to cut back on their spending. Therefore, it negatively affects the turnover of businesses.

This instability and uncertainty has caused businesses to set their priority strategies for 2022 as preventing contraction, increasing their domestic market share, and strengthening their share capital. Future expectations play a major role in the decision-making processes of businesses. The expectations

of the 201 businesses surveyed regarding the conditions of the economy in the second half of 2022 and in 2023 are as follows.

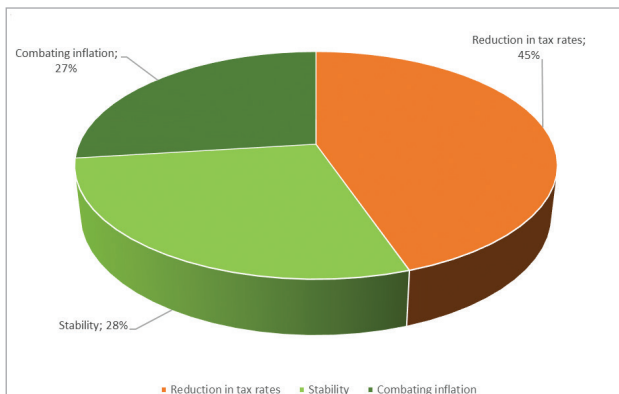
Figure 1.8 Economic expectations of businesses in the second half of 2022 and 2023



51% of businesses think that the economy will start to improve, 36% of them think that it will continue to be bad, and 13% of them think that the economy will get worse. In total, those who say it will be good and bad are almost equal in proportion. This finding can be interpreted as the impact of the significant recession in the economy for the last 2 years and lack of a full recovery since the beginning of 2022. In addition, the Russia-Ukraine war, and the food shortage it caused, the increase in commodity prices, the rising inflation and the risks related to the future prevented the businesses from expecting a significant improvement in the future.

As the last question of the survey, businesses were asked what their primary expectations from the government were. As can be seen from the figure below, reduction in tax rates, stability and counter-inflationary measures were stated to be the three most important expectations, respectively.

Figure 1.9 Businesses' three priority expectations from the government



The start of the COVID-19 pandemic at the beginning of 2020 and the low competitiveness of the economy, coupled with the government's inability to provide sufficient and timely support to keep the economy afloat, delayed recovery in the

TRNC economy. In addition, the increase in exchange rates and the government crises in the TRNC delayed the recovery from the crisis, which should have occurred in 2021, to 2022 as different from the rest of the world. The war between Russia and Ukraine, which started in the second month of 2022, has worsened the inflation and instability problem that has been going on since 2021. The increased risks due to the war and the global inflation combined with local problems have rendered expectations from the future in the country negative. The decline in purchasing power created by inflation and instability as well as tax and fee hikes to finance budget deficits created additional tax burden on businesses. Therefore, businesses ask the government to alleviate the burden caused by the eroded purchasing power, as well as to end the domestic political instability experienced and, finally, ensure price stability, by fighting against inflation.

The latest analyses show that the growth of the world's leading economies is expected to slow down with rising energy and other commodity prices. According to the World Bank, developing countries will come out of this process with greater losses, given the scarcity of fertilizers, food stocks and energy resources. It is obvious that the world is entering an economic storm and the possibility of experiencing stagflation has increased greatly. The TRNC is going into this storm fiscally weak, with high budget deficit and debt stock, economically unstable with high inflation and extremely volatile exchange rates. The government lacks a clear policy on how to solve the existing problems and compensate for the losses caused by what has transpired. This state of affairs naturally pushes households and businesses trying to generate income in the economy to a great uncertainty. Businesses have difficulty in making decisions about the future, especially businesses with weak capital structures are forced into bankruptcy. In addition, instability will particularly affect the low and middle-income segments of the community. The ongoing instability will further affect the low and middle-income segments of society and cause the income distribution in the country to deteriorate further, turning it into a social problem. Therefore, the government should develop clear policies to find direct solutions to the problems that could be experienced in the future of the TRNC and try to minimize uncertainty by sharing these with the relevant parties.

Priority Economic Policies

The government should develop economic policies for the main problems experienced in the TRNC. Inflation should come

first. The government must set out a clear and understandable policy to combat inflation. Fiscal policy should be set out in a more detailed and precise manner by devising short-, mid-, and long-term plans. In particular, tax and budgetary policies should be clearly stated, and businesses should know how much tax they will be paying in the coming months. On the expenditure side, the supplementary budget should be addressing problems alike inflation that has occurred in the first 5 months of 2022.

Effective policies should be developed especially for low- and middle-income groups, which are most affected by the instability and inflation, and these groups should be financially supported. Tax adjustments which are to finance budget deficits should be studied in more detail and those that cause inflation and distort market conditions should not be adopted.

METHODOLOGY FOR TRANSFORMATION READINESS

*From Competitiveness to
Transformation Readiness*

How Transformation Readiness is Measured

Country Scores

*Transformation Readiness Performance
of Northern Cyprus*

From Competitiveness to Transformation Readiness

The World Economic Forum renews its Competitiveness methodology from time to time depending on the changing economic and social conditions, but last year's special edition has been treated as an extraordinary situation that will likely be used only once, rather than updating the existing competitiveness methodology. Due to the unexpected developments experienced during the pandemic, special edition mainly tries to calculate the short-and medium-term readiness capacities of governments in the face of sudden developments and their capacity to achieve economic transformation in the near future.

In the special edition by the World Economic Forum, the capacity of countries to extricate themselves from the crisis and go into a growth trend again is assessed according to their current capacities in four areas and their transformation readiness therein. In addition to the policy priorities of the selected countries in the pre-pandemic period, their exit policies from the pandemic and the transformation readiness of the countries according to the conditions that will occur after the pandemic and their economic recovery potential are discussed. The four main policy priority areas that are envisaged to prepare the countries for transformation by overcoming the crisis and creating a sustainable recovery are as follows:

- i. Reviving and transforming institutional and physical infrastructure
- ii. Reviving and transforming human capital
- iii. Reviving and transforming markets
- iv. Reviving and transforming the innovation ecosystem

There are four areas of action identified for the functioning of the economy. The first of these is the policy area of “*reviving and transforming the enabling environment*”, where institutions and physical infrastructure are addressed in terms of ensuring physical (environmental) and institutional sustainability. In this context, physical infrastructure capacities such as transportation, communication and energy, and fiscal and monetary policy implementation capacities of governments, in other words, governance capacities in general are discussed. Therefore, the transformation and revitalization capacity of a country is evaluated not only by considering the economic growth figures, but also by considering the institutional structures and sustainability targets.

The second policy priority area is “*reviving and transforming human capital*”, which looks into the adaptation of human

capital, the main component of production, to newly developing needs. The human capital mentioned here refers to the skill, experience and education level of the existing workforce rather than the number of qualified workforce and the number of people. It is clear that with the developing technology and new production models, different skill needs have emerged and will continue to emerge. This area of action recommends that the education systems be transformed considering the new skills businesses demand in the labour markets and that policies to support such transformation should be developed. This area also includes meeting the health and care needs of the workforce.

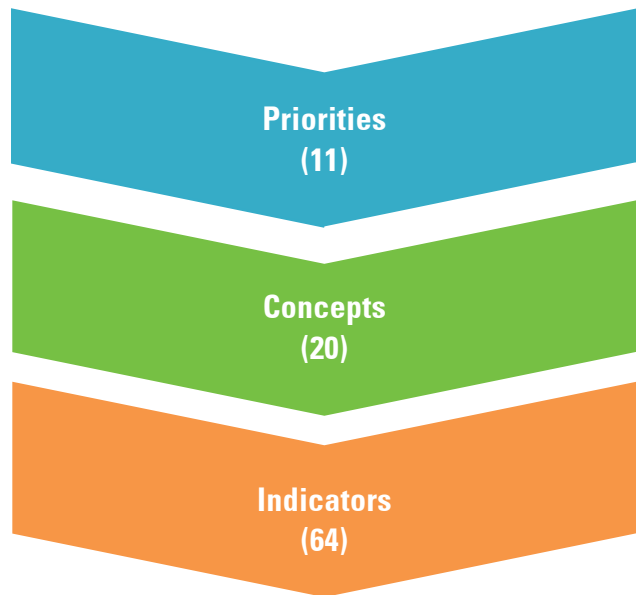
The third policy area is “*reviving and transforming markets*”, aiming to transform the markets and ensure effective allocation of resources. This includes objectives such as reactivation of goods and service markets, especially financial markets, in the transformation process, preventing the market dominance of digital businesses and platforms with technological transformation and preventing development from falling into the hands of only a limited number of enterprises. That is why reviving and transforming markets is addressed as a separate policy priority area owing to its enhancing effects on the efficiency of resource allocation as well as fair access to resources and consumer welfare.

The last policy priority area is “*reviving and transforming the innovation ecosystem*”. Innovation ecosystems encompass comprehensive processes ranging from creating innovative ideas to transforming them into products and commercializing those products to a great extent. For this reason, it is essential to transform existing innovative ecosystems in order to ensure a sustainable revival and transformation. In recent years, investments in green technologies have not increased at the same rate as economic growth, and to close this investment gap and transform its content, governments should support more R&D investments, innovations, and inventions in public-private partnerships, as well as incentivize firms to embrace diversity, equity and inclusion to enhance creativity.

How Transformation Readiness is Measured

11 Priority areas have been determined to measure the level of countries’ readiness for transformation for the special edition by the World Economic Forum. Under these 11 Priority areas, a total of 20 concepts and a total of 64 indicators have been identified that help define each concept. Some of the indicators were obtained from published international statistics, while others were obtained through the World Economic Forum’s

standard Executive Opinion Survey applied in each country. While 25 of a total of 64 indicators consist of measurements based on the opinions of executives, 39 of them consist of published statistics.



While 130 to 140 countries were included in the Competitiveness Reports in previous years, in Special Edition only 37 countries, most of which are OECD members, were included. One reason for this is the absence of many of the indicators used in the calculations of the special edition in most of the countries not included in the assessment. Similarly, unlike in previous years, countries were not ranked in any order after their transformation readiness scores were calculated. One reason given for this was the continuation of the pandemic, and the lack of indicators in some countries. In analyses regarding each country’s score, their strengths and weaknesses for transformation are noted, and policy recommendations are made for the short and long term.

Country Scores

According to the methodology used in the Special Edition, transformation readiness scores were calculated for each country for the existing indicators out of a total of 64 indicators under 11 priority areas. In Table 2.1 below, a total of 38 countries, including 37 countries included in the original study and Northern Cyprus, where the country score was calculated with the same methodology (as provided in the Appendix 1), and the transformation readiness scores are presented in alphabetical order. The list includes the transformation readiness score of each country, the number of areas available and used from 11 priority areas, and the number of missing 64 indicators under the priorities.

Table 2.1

| COUNTRY/ECONOMY | SCORE (0-100) | DECILE | PRIORITIES MEASURED | NUMBER OF MISSING INDICATORS |
|--------------------|---------------|--------|---------------------|------------------------------|
| Argentina | 49.0 | 9 | 10/11 | 6 |
| Australia | 62.0 | 4 | 11/11 | 3 |
| Austria | 60.3 | 6 | 11/11 | 5 |
| Belgium | 63.6 | 3 | 11/11 | 4 |
| Brazil | 51.0 | 8 | 10/11 | 7 |
| Canada | 64.2 | 2 | 11/11 | 6 |
| Chile | 53.0 | 7 | 11/11 | 4 |
| China | 65.5 | 2 | 10/11 | 8 |
| Czech Republic | 54.0 | 7 | 11/11 | 5 |
| Denmark | 66.5 | 1 | 11/11 | 3 |
| Estonia | 61.0 | 5 | 11/11 | 5 |
| Finland | 69.9 | 1 | 11/11 | 5 |
| France | 62.7 | 3 | 11/11 | 2 |
| Germany | 62.9 | 3 | 11/11 | 2 |
| Greece | 47.2 | 10 | 11/11 | 3 |
| Hungary | 48.1 | 10 | 11/11 | 2 |
| India | 49.5 | 9 | 10/11 | 7 |
| Indonesia | 55.3 | 7 | 9/11 | 6 |
| Ireland | 60.9 | 6 | 11/11 | 5 |
| Israel | 62.7 | 3 | 11/11 | 5 |
| Italy | 51.9 | 8 | 11/11 | 2 |
| Japan | 61.9 | 5 | 11/11 | 3 |
| Korea, Rep. | 61.2 | 5 | 11/11 | 2 |
| Mexico | 46.9 | 10 | 11/11 | 5 |
| Netherlands | 66.3 | 2 | 11/11 | 3 |
| New Zealand | 64.0 | 2 | 11/11 | 4 |
| North Cyprus | 37.2 | 10 | 8/11 | 31 |
| Poland | 48.8 | 9 | 11/11 | 2 |
| Portugal | 56.1 | 6 | 11/11 | 3 |
| Russian Federation | 50.4 | 8 | 9/11 | 7 |
| Slovak Republic | 49.7 | 9 | 11/11 | 4 |
| South Africa | 50.4 | 8 | 10/11 | 9 |
| Spain | 56.5 | 6 | 11/11 | 5 |
| Sweden | 68.5 | 1 | 11/11 | 3 |
| Switzerland | 62.5 | 4 | 11/11 | 6 |
| Turkey | 45.2 | 10 | 11/11 | 4 |
| United Kingdom | 61.4 | 5 | 11/11 | 2 |
| United States | 62.2 | 4 | 11/11 | 4 |

Table 2.2 below shows the highest performing countries and the lowest performing countries in each of the 11 priority areas. In addition, the average score, and the highest

and lowest country scores in each priority area are also displayed. Sub-scores obtained by all countries in the priority areas and the country scores are included in Annex-2.

Table 2.2

| ÖNCELİKLER | BEST PERFORMING COUNTRIES | AVERAGE SCORE | LEAST PERFORMING COUNTRIES |
|--|--|---------------|---|
| Priority 1 Ensure public institutions embed strong governance principles and a long-term vision and build trust by serving their citizens | Finland (78.5) New Zealand Switzerland | 60.0 | Mexico Brazil Russia (42.8) N. Cyprus (33.8) |
| Priority 2 Upgrade infrastructure to accelerate the energy transition and broaden access to electricity and ICT | Estonia (99.8) Denmark Netherlands | 78.7 | South Africa Indonesia Russia (57.2) |
| Priority 3 Shift to more progressive taxation, rethinking how corporations, wealth and labor are taxed, nationally and in an international cooperative framework | South Africa (65.2) Japan South Korea | 50.0 | Italy Poland Hungary (30.7) |
| Priority 4 Update education curricula and expand investment in the skills needed for jobs and “markets of tomorrow” | Finland (75.3) Denmark Netherlands | 55.3 | Turkey Brazil Greece (38.8) N. Cyprus (31.9) |
| Priority 5 Rethink labor laws and social protection for the new economy and the new needs of the workforce | Denmark (77.0) United Kingdom Switzerland N. Cyprus (62.3) | 61.4 | Greece India South Africa (42.9) |
| Priority 6 Expand eldercare, childcare and healthcare infrastructure, access and innovation for the benefit of people and the economy | Sweden (75.9) Denmark Canada | 48.7 | N. Cyprus (34.9) Portugal Poland Greece (24.7) |
| Priority 7 Increase incentives to direct financial resources towards long-term investments, strengthen stability and expand inclusion | Finland (95.4) Sweden New Zealand | 69,2 | USA South Africa N. Cyprus (33.3) Argentina(32.8) |
| Priority 8 Rethink competition and anti-trust frameworks needed in the Fourth Industrial Revolution, ensuring market access, both locally and internationally | USA (77.6) Canada China | 62,0 | Slovakia Argentina Russia (42.5) N. Cyprus (36.5) |
| Priority 9 Facilitate the creation of “markets of tomorrow”, especially in areas that require public-private collaboration | Finland (59.5) USA Japan | 45,1 | South Africa Greece Argentina (34.3) N. Cyprus (25.6) |
| Priority 10 Incentivize and expand patient investments in research, innovation and invention that can create new “markets of tomorrow” | USA (57.3) Japan İsrael | 41,6 | Turkey Mexico Greece (25.2) |
| Priority 11 Incentivize firms to embrace diversity, equity and inclusion to enhance creativity | China (79.2) New Zealand Australia ABD | 62,2 | Turkey Italy N. Cyprus (45.7) India (45.1) |

One of the most striking results of the study is that no country is ready for transformation. The executive opinion survey results indicate that the executives think the progress towards transformation stopped and even went backwards during the pandemic. The five areas that declined the most during the pandemic in developed economies are as follows: competition in network services, business-to-business cooperation, competition in professional services, competition in retail services, ease of finding skilled workers. The areas that regressed the most in emerging and developing economies are as follows: the cost of crime and violence for businesses, questionable judicial independence, rise in organized crime, dominance in markets, and lack of trust in politicians.

The executive opinion survey also shows that some countries are better able to manage the economic and social impacts of the pandemic. It is believed that digital skills, digitalization of the economy, safety nets and financial soundness, governance and planning, and improvements in research and development activities in health systems have been helpful in alleviating the impacts of the pandemic.

Table 2.3 Lagging and Progressing Areas During the Pandemic

| According to Executive Surveys | Developed Economies | Developing Economies |
|--|--|---|
| Progressing Areas during Crisis | <ul style="list-style-type: none"> • Competition in transportation and communication services • Collaborations between companies • Competition in Professional services • Competition in retail area • Ease of finding skilled employee | <ul style="list-style-type: none"> • Cost of crime and violence to firms • Judicial Independence • Organised crimes • Market dominance • Reliability of politicians |
| Lagging Areas during Crisis | <ul style="list-style-type: none"> • Governments' responsiveness to change • Internal cooperation in firms • Availability of start up capital • Social safety net protection • Soundness of banks | <ul style="list-style-type: none"> • Governments' responsiveness to change • Efficiency of railway transportation • Availability of start up capital • Ability of country to attract skills from abroad |

"Reviving institutional and physical structures", which is the first of the four policy areas determined by the World Economic Forum for the purpose of assessing transformation readiness, has been measured with the indicators under priority 1 and priority 2. Priority 1 is defined as "Ensure public institutions embed strong governance principles and a long-term vision and build trust by serving their citizens". Indicators under priority 1, which mainly consist of indicators measured by opinion-based executive surveys, include elements related to public services and management such as the judicial independence, corruption perception, government's responsiveness to change, government long-term vision. Finland has achieved the highest score in this section, followed by New Zealand and Switzerland, respectively, while Russia has obtained the lowest score, followed by Mexico, Brazil, and Argentina. Executive survey results show that after the 2008 financial crisis, there has been a consistent erosion of institutions reputations across regions, including weaker checks and balances and less transparency. Governments' long-term vision is also one of the indicators in this section, and it is clear that the measurement of governments' performances in this area needs to be associated with environmental and institutional targets too beyond just economic growth.

Priority 2 consists of indicators based on the upgrading of and access to infrastructure. Priority 2 is defined as "upgrade infrastructure to accelerate the energy transition and broaden access to electricity and information and communication technologies (ICT)". Most of the indicators in this section are calculated by scoring based on country statistics, which takes into account the status of existing infrastructure in countries, access to infrastructure and legislation regarding infrastructure. Estonia achieved the highest score in priority 2 with almost a full score, followed by Denmark and the Netherlands, respectively. While Russia had the lowest score again, South Africa and Indonesia were also the other lowest scoring countries in this priority area.

Upgrading the infrastructure will expand the energy transition and access to electricity and information and communication technologies. While the average fixed broadband internet prices in emerging and developing countries are about 20 times as high as those in advanced countries, the price consumers pay to buy this basket is more than one-sixth of the average salary. While these excessive prices are due to insufficient infrastructure and the absence of a competitive environment, they negatively affect access to the internet and information technologies. While the development and

expansion of infrastructure should be among the priorities of public investments, studies show that infrastructure investment projects that are not planned correctly can create more losses than benefits and cause waste of resources. In an analysis made in the countries included in the study, it was found out that because of inefficient infrastructure project investments and implementations, 30 to 40% of public expenditures was wasted. It is seen that a better investment would have been obtained at lower cost had the right planning, comprehensive budgeting, fair tender processes, and project monitoring been applied in the selection of projects. According to IMF estimates, increasing public investments by 1% of GDP can create around 7 million direct jobs and 20 million indirect jobs worldwide. Investments in health, transportation, housing, digitalization, and energy transition not only increase competitiveness, but also create more employment and make countries more resilient and sustainable.

Priority 3 is mostly taxation-related and is defined as “shifting to more progressive taxation, rethinking how corporations, wealth and labour are taxed, nationally and in an international cooperative framework”. In this priority, South Africa has achieved the highest score, while Japan and South Korea were the other high-scoring countries in taxation. While Hungary has obtained the lowest score in this area, the other EU countries Italy and Poland have also got the low scores.

Priority 4, 5 and 6 consist of priorities for reviving and transforming human capital. Priority 4 is defined as “update education curricula and expand investment in the skills needed for jobs and ‘markets of tomorrow’”. Indicators under this priority consist of variables related to the training and skills of the workforce, mainly based on the results of the executive survey, such as in-house personnel training, digital skills, and critical thinking in education. Finland has achieved the highest score in this priority, followed by Denmark and the Netherlands. The country with the lowest score was Greece, while Turkey and Brazil were other countries with low scores on education and digital skills.

As digital processes become widespread in the fields of production, consumption, distribution and marketing, the demand for digital skills has started to increase. The fact that education models are still created with more traditional content and methods in many countries causes the digital skills gap to grow. Skill gaps between advanced and emerging and developing countries are also on the rise. The adequacy of secondary education systems to meet the needs of employment is rated at 59 points out of 100 in advanced economies and

42 points in emerging and developing economies. While the scores of some countries with large populations (India, US, Germany) decreased in this area, some countries such as Korea, Saudi Arabia and Turkey improved their scores. The adequacy of tertiary education to meet the needs of employment is rated at 68 points in advanced economies and 55 points in emerging and developing economies. Despite all these developments, the “ability to find skilled employees” has declined across advanced economies by 7% relative to 2016, while improving across developing economies by 3%. To train personnel for the professions of the future, first of all, the curricula and education models of vocational and technical education as well as university education should be transformed. This kind of a transformation should be taken into consideration for both students and workers and should include on-the-job training. In the medium term, there is a need for policies that guide workers to new professions and jobs with skill gaps. In addition to financial support to be provided for SMEs, employment-generating support programmes such as entrepreneurial clusters and quality-oriented apprenticeship programmes can pave the way for professions of the future. There is a greater need for such interventionist policies to meet the growing skills gap.

Since the sustainability of human capital is considered to be based on the existence of strong health and education systems, priority 5 is built on labour laws and provisions to protect employees. Priority 5 is identified as “rethinking labour laws and social protection for the new economy and the new needs of the workforce”. Indicators under this priority consist of labour market arrangements such as active labour market policies, minimum wage, overtime policies, and indicators such as access to health systems, government housing support allowances, and social security prevalence. Denmark has achieved the highest score in priority 5, while the United Kingdom and Switzerland were other leading countries. South Africa has achieved the lowest score in this area, while Greece and India were also the countries with the lowest scores. Health services, health infrastructure and skills in this field have lagged behind two key demographic developments. These are respectively the aging population in developed countries and rapid population growth trends in developing countries. Average life expectancy has jumped by four years since 2010, and by nine years since 1990. This progress is largely due to improved sanitation across developing economies as well as, more broadly, to the emergence of new medical technologies. Such positive figures mask persistent under-investment in health system capacity which has become

more apparent during the COVID-19 pandemic. It is important to increase the number health personnel and improve health infrastructure in the short and medium term to be prepared for similar pandemics in the future and to cope with the potential pressure that population dynamics may create on health.

Priority 6 is set as “expanding eldercare, childcare and healthcare infrastructure, access and innovation for the benefit of people and the economy”. Indicators under this priority consist of the budget allocated by the state for childcare, pre-primary education and early childhood education, the budget for healthcare, and the number and qualifications of the eldercare workers. Sweden has scored the highest in this area, while Denmark and Canada were other top performers. The lowest performer in this priority area has been Greece, while Portugal and Poland are other poor performing countries. In the short term, there is a need for new public policies that support the income and upskilling of healthcare workers. The expansion and increase of technology use in these areas and the development of innovative business models will contribute to the creation of a higher-paid healthcare worker profile that can provide higher quality services.

Another way to revive and transform the economy will be through the revitalization and transformation of markets. Priority 7, 8, and 9 have been set to measure this. Priority 7 is “increase incentives to direct financial resources towards long-term investments, strengthen stability and expand inclusion”, covering mainly the soundness and improvement of financial markets. Some of the indicators under this priority include adoption of ethical standards by firms and use of digital financial services among poor population. Finland has achieved the highest score in this priority area, while Sweden and New Zealand are the other successful countries. The lowest scoring country has been Argentina, while South Africa and the US are identified as other low-performing countries. To achieve progress in this area, it is recommended that incentives should be provided to direct financial resources towards long-term investments, stability should be strengthened, and inclusion should be expanded.

Priority 8 is “rethink competition and anti-trust frameworks needed in the Fourth Industrial Revolution, ensuring market access, both locally and internationally”. Some of the indicators under this priority are as follows: growth of innovative companies, financing of SMEs, market dominance, state of cluster development, and ratio of unemployment between rural and urban populations. The United States has scored the highest in this priority area, while Canada and China have

been measured as the other high scoring countries. The worst performing country is Russia, while Slovakia and Argentina are other low-scoring countries. While the loose monetary policy put in place after the 2008 financial crisis made it easier to access credit, low interest rates reduced lending standards with monitoring incentives. The responses given in the executive opinion survey showed that SMEs’ access to credit increased after the 2008 crisis. However, despite all this abundance of credit, it seems not to have developed at an equal level globally. Millions of households in many developing countries cannot access financial services and credit. For instance, according to the IMF’s Financial Access Survey, in most Sub-Saharan African countries there are fewer than four bank branches per 100,000 people, while in most European and North American countries there are between 20 and 50. For transformation readiness, not only should access to credit and investments be boosted but also use of credit by businesses operating in accordance with environmental, social, and institutional governance principles should be incentivized.

Priority 9 is “facilitate the creation of “markets of tomorrow”, especially in areas that require public-private partnership”. Indicators used in this priority area focus on consumption and consumers. Indicators such as consumption-based emissions per capita, consumer uptake of new technologies, regulation of emerging technologies, buyer sophistication, public sector role in fostering demand for new technologies are measured on the perception-based executive opinion survey. Finland has scored the highest in priority 9, while the United States and Japan are the other high-performing countries. The country with the lowest score in this area is Argentina, while South Africa and Greece are the other low-performing countries. The World Economic Forum has identified 20 innovative “markets of tomorrow”. These include the market for EdTech and reskilling services, the market for data, and the market for care services. There is a need to facilitate public-private partnerships in the creation of future markets.

The goal of reviving and transforming the innovation ecosystem is measured using priority 10 and 11. Priority 10 is “incentivize and expand patient investments in research, innovation and invention that can create new “markets of tomorrow”. The indicators for this priority are the state of R&D investment in new technologies and the public sector initiative in R&D for new technologies. While the United States has the best performance in this field, Japan and Israel are other successful countries. While Greece has received the lowest score in this area, Turkey and Mexico are other low-

performing countries. Public R&D funding is among the types of investments that can generate the highest number of good-quality jobs. For instance, in OECD economies five new jobs are created with every \$1 million invested on public R&D. The jobs created are twice as many when the investment is channelled through higher education institutions.

The other priority regarding the revitalization and transformation of the innovation ecosystem is priority 11, the final one, which is specified as “incentivize firms to embrace diversity, equity and inclusion to enhance creativity”. The indicators for this priority focus on equality and diversity in businesses and are as follows: diversity of workforce, reliance on professional management, share of firms with a female (co-)owner. The country with the highest score in this priority area is China, while New Zealand, Australia and the US are other successful countries. The country with the lowest score is India, while Turkey and Italy are also measured as the other lowest performing countries.

Transformation Readiness Performance of Northern Cyprus

As it was done in every year’s Competitiveness Reports, the same methodology used by the World Economic Forum has been applied to Northern Cyprus to calculate the transformation readiness score of the Northern Cyprus economy. With the addition of Northern Cyprus to the 37 economies assessed in the original special edition, the transformation readiness performances of 38 countries have been compared. Using the executive opinion survey questions, the perceptions of business executives in Northern Cyprus about different areas of the country have been collected through face-to-face or telephone interviews with approximately 100 executives. The scores obtained have been used to calculate the “transformation readiness” score of the Northern Cyprus economy. Out of a total of 64 indicators that are used in the calculation of the country transformation readiness score, the data for 25 are collected via the survey while the data for the remaining 39 are compiled from international statistics. As part of the latter not compiled in Northern Cyprus, so only 6 published statistics and 25 indicators obtained from executive surveys making a total of 31 indicators were used for Northern Cyprus country score. The calculation, realized without the inclusion of the missing data, has found that Northern Cyprus’ transformation readiness score is 37.2 out of 100. The Northern Cyprus transformation readiness score, which is well below the average score of 57.1 of the 37 countries included in the

special edition, is the lowest score among the participating countries. Of course, the fact that only 37 countries are included in the calculations this year, instead of around 130-140 countries as before, is due to the lack of data for the indicators used in this year’s methodology. As only eight of the 11 priority areas used to measure transformation readiness have sufficient indicators for Northern Cyprus, none of the indicators in three areas could be included in the calculation (These are priority areas 2, 3 and 10).

Table 2.4 Best and Worst Indicators of North Cyprus

| Best Indicators | Score |
|--------------------------------------|-------|
| Working Life Regulations | 96.2 |
| Gender parity in tech roles | 60.7 |
| Judicial independence | 49.5 |
| Accessibility of healthcare services | 47.5 |
| Worst Indicators | Score |
| Critical thinking in teaching | 27.3 |
| Availability of Venture Capital | 25.3 |
| Regulation of emerging Technologies | 16.5 |
| Government long-term vision | 8.0 |

The indicators in priority 1 are mostly focused on the perception of public services and administration such as judicial independence, corruption, government’s responsiveness to change, and government long-term vision. While the score of Northern Cyprus in this area is 33.8, the average of other countries in this section is calculated as 60 points. While the Russian Federation received the lowest score with 42.8 in priority 1, Northern Cyprus has received a score even below it. Among the eight indicators under priority 1 for Northern Cyprus, the highest score belongs to the judicial independence indicator with 49.5. It is therefore concluded that the executives in Northern Cyprus rate judicial independence higher than other public policies in this perception-based measurement.

Since none of the indicators in the priority 2 and 3 are calculated in Northern Cyprus, these two priority areas are not included in the calculation of the Northern Cyprus country score. Priority 2 is defined as “upgrade infrastructure to accelerate the energy

transition and broaden access to electricity and information and communication technologies (ICT)" while priority 3 is specified as "shifting to more progressive taxation, rethinking how corporations, wealth and labour are taxed, nationally and in an international cooperative framework".

Priorities 4, 5, and 6 focus on reviving and transforming human capital, with priority 4 being specified as "update education curricula and expand investment in the skills needed for jobs and 'markets of tomorrow'". Northern Cyprus's score in priority 4 is 31.9 out of 100, well below the 50 point-average of other countries. The lowest score in this area was achieved by Greece with 38.8 points, while Northern Cyprus is also below it. The highest sub-score in this field, which consists of indicators related to the skills and experiences of the workforce, came from the field of "digital skills among active population" with 42.8 points. Priority 5 is about the legislation regarding the labour market and protection of workers. Priority 5 is identified as "rethinking labour laws and social protection for the new economy and the new needs of the workforce". It is the area in which Northern Cyprus has achieved the highest score among all the priorities with a score of 62.8. With this score, for the first time, Northern Cyprus goes over the average score of 61.4 for the other countries, and it has been able to perform better than the countries with the lowest score. Although there are missing indicators in this area, which includes indicators about working life such as minimum wage level, overtime allowances, and employee rights, a high score could be achieved with the data from the existing indicators. Priority 6 is "expand eldercare, childcare and healthcare infrastructure, access and innovation for the benefit of people and the economy". Indicators under this priority consist of the budget allocated by the state for childcare, pre-primary education and early childhood education, the budget for healthcare, and the number and qualifications of the eldercare workers. Northern Cyprus' score in this section is 34.9, below the average of 47.1 for the other countries but still a better score than countries such as Greece, Turkey, and Poland, which registered the lowest performance in this section. In particular, public expenditure on health services has been the most successful indicator of Northern Cyprus in this area.

Revival and transformation of the markets is measured through the indicators under priority 7, 8 and 9. Priority 7 is "increase incentives to direct financial resources towards long-term investments, strengthen stability and expand inclusion", covering mainly the soundness and development level of financial markets. In this area, where adoption of

ethical standards by businesses is assessed in a perception-based survey, Northern Cyprus has achieved 33.3 points, which, albeit below the average, is higher than the lowest performer Argentina's score. Priority 8 is "rethink competition and anti-trust frameworks needed in the Fourth Industrial Revolution, ensuring market access, both locally and internationally". Some of the indicators under this priority are as follows: growth of innovative companies, financing of SMEs, market dominance, state of cluster development, and ratio of unemployment between rural and urban populations. Northern Cyprus has achieved a score of 36.5 in this section, which is below the average score and the lowest score of any country. This reveals a need for more innovative initiatives and an increased level of competition in the markets to revive the markets. Priority 9 is set as "facilitate the creation of "markets of tomorrow", especially in areas that require public-private collaboration" and consumption and consumer-related indicators have been measured within this priority. Northern Cyprus' score in this area is the lowest of all its scores. Naturally, this score is the lowest priority score among all priority scores of all the countries.

Priorities 10 and 11 are designed to measure the goal of reviving and transforming the innovation ecosystem. Priority 10 is "incentivize and expand patient investments in research, innovation and invention that can create new "markets of tomorrow". Since the indicators in this priority was not compiled in Northern Cyprus, this priority area could not be calculated. Priority 11 is specified as "incentivize firms to embrace diversity, equity and inclusion to enhance creativity". The indicators for this priority focus on equality and diversity in businesses and are as follows: diversity of workforce, reliance on professional management, share of firms with female (co-) owners. The country score of Northern Cyprus in this area has been calculated to be 45.7 and it is the second highest country score it has achieved after the labour force and work area. As in many other fields, it is below the average of other countries in this area too and has achieved a score close to India, which has received the lowest score in this field. Although its score in women in technology roles indicator is above the average with 60.7, the remaining indicator scores are at a very low level.

All the countries selected by the World Economic Forum for this assessment consist of countries with far better performing economies than that of Northern Cyprus in terms of population, scale, and income level. Of course, the skills, institutional soundness, and proportional sizes also play an important role in the transformation of an economy, besides

the material size. However, the country selection criterion of the World Economic Forum was the presence of the indicators used in the methodology rather than the country size. Northern Cyprus participates in this assessment every year in addition to the countries in the study. It has been added to the study this year despite the lack of many of the necessary indicators, and, consequently, the r transformation readiness scores are relatively low. It could always find a place somewhere between 100 and 110 among the 140 countries in the Global Competitiveness reports that included 130-140 countries in normal years. Therefore, the results from this year's special edition report are not surprising.

The clear takeaway from the special edition is that no country is fully ready for transformation yet. Another clear conclusion is that all countries, whether part of the study or not, must start preparations for transformation as soon as possible. This transformation has urgent economic, human, environmental and institutional requirements. To achieve the transformation, there is a need for governments to adhere to strong governance principles, as well as to develop innovative approaches and long-term thinking in the delivery of public services. Restoring public confidence in governments and public institutions, rapidly digitizing the services offered, enhancing the quality of service, and restoring the lost trust are of paramount importance in starting the transformation. Even though some countries started the digitalization process by improving their information infrastructure prior to the pandemic, many developing countries started to focus on digitalization with the pandemic and hence are not ready for sufficient transformation. In this transformation process, global infrastructure development, access to electricity and energy diversification should be prioritized. Although teleworking, video meetings, and many other web functions became popular with the pandemic, use of these facilities should be developed further and expanded both domestically and internationally. In addition, it is clear that the development of physical infrastructure alone will not be sufficient for digital transformation and that human capital should be equipped with digital skills as well. It is also clear that the human resources required by the new world cannot be achieved with the existing education methods and curricula. This indicates that educational methods and curricula should be transformed in response to the growing needs. Likewise, businesses need to renew their business models by considering technological and human development. While all these efforts are under way, there is also a need for legislation, institutional structures, and, most importantly, physical infrastructure to be upgraded

and reinforced. In short, the transformation has begun. In light of this, there is a need for renewal at the individual, social and institutional levels, organizing by anticipating the innovation, and achieving transformation through local and global cooperation.

FOREIGN MARKET COMPETITIVENESS AND EXPORT OPPORTUNITIES OF TRNC AGRICULTURAL SECTOR

Fundamental Problems in the Agricultural Sector

Export Opportunities in the Agriculture Sector

Green Line Trade

EU Market

Global Organic Market

UK Market

Republic of Turkey Market

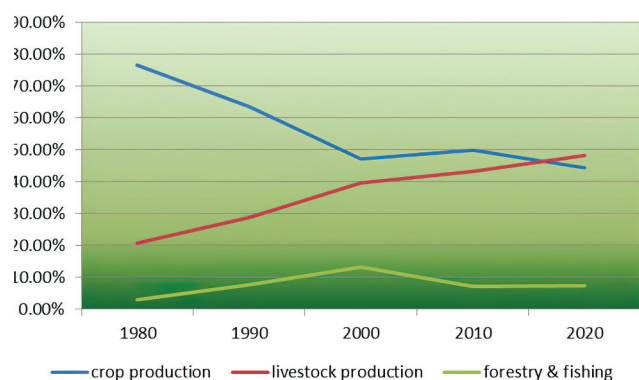
Northern Cyprus: What To Do?

1. Agricultural sector of North Cyprus has traditionally been one of the most important economic activity areas for Turkish Cypriots. The agricultural sector had an undeniable importance on national income and employment, both during the Republic of Cyprus era and in the post-1974 period. However, as is usual in all countries that have inevitably entered the process of economic development, the share of agricultural production and employment in national income is also decreasing in Northern Cyprus. The share of agricultural production in national income declined below 10% from about 15 to 20% trend in the 1980s, and it has been following a flat trend in the 5-to-7% band in the last decade. Similarly, the share of agricultural employment has declined from 30 to 40% in the 1980s to below 6% and settled in the 3-to-5% band in the past decade. Considering the water coming from Turkey, this trend is expected to gain momentum in the coming years.

2. A look at the historical development of the sector shows that the agricultural sector grew by around 2.2% on average every year from 1977 to 2019, while the country's economy grew by approximately 3.8% in the same period. Similarly, there is instability in agricultural sub-sectors. Of the crop and livestock production, which together make up 95% of the agricultural sector, there seems to be more instability in crop production. **However, there is a stable development in the livestock sector.**

3. The development in livestock production has also increased its relative importance in the agricultural sector. As can be seen in the figure, livestock farming, which had a share of 21% in the 1980s, today constitutes 48% of the sector. During the same period, the share of crop cultivation went from 76% in the 1980s down to 44% in 2020. The fact that fisheries have not grown in importance despite being an island country is an issue that needs to be addressed separately.

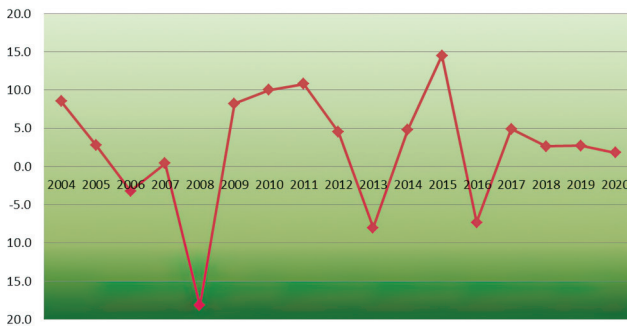
Figure 3.1: Development Agricultural Sub Sectors (1980-2020, %)



Source: Calculated using the State Planning Organization (SPO) data.

4. One of the most important structural problems of the agricultural sector is the instability in production. Main reasons for this is that the sector is structurally dependent on natural conditions. As can be seen in the figure, the increase in real production fluctuates excessively from year to year and experiences significant contractions at times. **The main reason for this is the heavy dependence on natural conditions, especially in crop cultivation.**

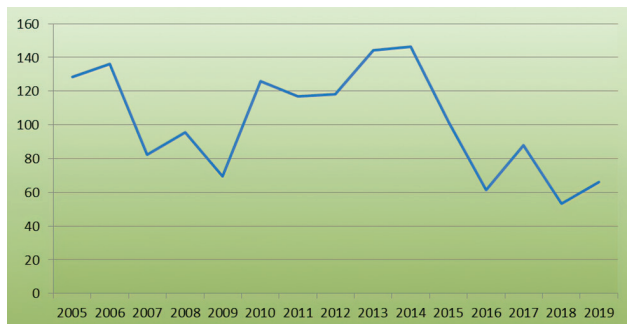
Figure 3.2: Real Growth Rate of the Agriculture Sector by Years (% Change)



Source: SPO

5. A factor that relatively reduces the excessive fluctuations in agricultural production and the dependence on nature is mechanization and similar investments made in the sector, which directly affect productivity. Investment from bank loans into the sector follows a downward trajectory in the TRNC, dropping from 128 thousand TL in 2005 to about 60 thousand TL in 2019 (in real terms). It is also recognized that farmer revenues, which change from time to time depending on the climatic conditions, also partially affect this investment trend positively or negatively. **Considering that mechanization** in the agricultural sector is a factor directly affecting productivity, the decrease in investments in the sector is a simple indicator that technology is not being adapted sufficiently in agricultural production.

Figure 3.3: Fixed Capital Investments in Agricultural Sector (1977 Prices, thousand)



Source: SPO

6. Another notable point about investments is that investments are dependent on farmer earnings, independent of the development of the financial system. Investments in the sector follow a fluctuating trend with excessive increases or decreases in investment amounts depending on climatic developments. For example, in 2009, it is seen that the amount of investment in the sector decreased excessively due to the 2008 drought. This is also an indication that the government does not sufficiently support investments in the sector. However, public policies in developed countries are oriented towards supporting the farmer with income support or investment support instead of price support.

7. Agricultural outputs also differ from Mediterranean countries with similar environmental and climatic conditions. First of all, the livestock sector has a much higher share than in similar countries. Likewise, the share of the fruit and vegetable sector is smaller than in its counterparts. **The main reason for these and similar different outcomes is the economic embargo on the country and the fact that the sector is detached from international competition due to an economic setup with limited openness to the outside world.** This causes the potential in the sector not to be fully tapped and may result in results such as **specialization in wrong crops**, as determined by the World Bank in its 2006 Turkish Cypriot Community report. For years, sector has produced primarily for the domestic market and for halloumi, which is the niche product for which it has the most important export potential, without being under the international competition conditions and pressure.

8. The export data of the TRNC agricultural sector indicate that the exported products are squeezed into a somewhat narrow range. Today, processed and unprocessed agricultural products constitute a very large part of the country's exports. According to 2019 data, about 82% of the TRNC's export of approximately \$88 million consists of agricultural products. However, it is seen that the product variety in the export in question is low and the export markets are dependent upon a limited number of countries and regions. In addition, when we look at the historical development, it is seen that the only area that shows a significant improvement in the agricultural exports of the TRNC is dairy products. In the light of these data, it can be emphasized that export figures are far from reflecting the country's true potential in this sector, due, inter alia, to the impact of the embargoes.

Fundamental Problems in the Agricultural Sector

9. The embargo on the TRNC economy has brought along many negative structural problems for the country's economy. The most important of these problems is an economic structure that is far from being flexible and dynamic due to not being able to compete with the world in a closed economic setup, as a result of which the real economic potential of the country cannot be realized. However, beyond all this, one of the most important effects of being commercially isolated is the inability to establish the necessary technical and legal infrastructure and the associated institutional organization to implement the rules espoused by international trade. In other words, **a system in which the entire production, processing, and marketing process is under control, from the farm to fork, has not been fully set up.** Main structural and cyclical problems encountered in the sector can be summarized in more detail as follows:

10. Lack of Sectoral Strategy & Policy: Firstly, a close examination of the agricultural policies shows that the main problem in the agricultural sector, as agreed by all parties, is the lack of an agricultural strategy that is developed with the participation of all stakeholders. Let alone long-term strategies, the state has difficulties in maintaining even the short-term policies determined periodically. It is observed that all these problems cause producers to be unable to make even short-term production-investment plans and disrupt the debt-credit balance in the sector. Although the "TRNC Agricultural Master Plan", which has been developed and shared with the public recently by the Ministry of Agriculture, is an important step in this direction, this should be accepted only as starting ground for further work. **What needs to be done after this point is to ensure the realization of the general objectives specified in the master plan with more specific actions in various fields. This lack of micro strategy situation has not changed with the arrival of water from Turkey either.**

11. Scale Problem: The average farm size of agricultural holdings is well below both the EU averages and the Southern Cyprus averages; one of the reasons for this situation is that some of the farmers engage in agriculture as a second job. Income diversification in rural areas can be considered a good development, but in Northern Cyprus, the main source of this diversification is public employment. This poses an important obstacle to enterprises moving to a level where they can reap profits and invest in technology. In recent years, we see that other entrepreneurs have started to partially fill the gap in this field, instead of actors from the agricultural sector.

12. Inability to Create Added Value: Product processing amenities are far from realizing the potential of the sector. This causes the problem that agriculture cannot fully realize its complementary features, especially in areas such as the service sector, and cannot create added value that will tap its potential. To give a very striking example at this point, the figures about artichoke are of note. Despite the sustainability of water resources, an uncontrolled artichoke production is carried out in our country. While artichokes are planted on an area of approximately 900 decares in Southern Cyprus, artichokes are planted in a much larger area in our country. This means that large amounts of artichokes end up drying up on branches every year. Therefore, there are two actions that the ministries in charge of directing the country's economy should take at this point. **First of all, some of the production factors should be directed to product processing besides artichoke cultivation. Secondly, they should shift the crop pattern to high value-added crops with export potential, taking into account the high costs and environmental sustainability.**

13. Insufficient Organization in the Sector: Beyond all these, another important factor to be noted is the deficient and inadequate organization in the agricultural sector. While price support to agriculture has been reduced in EU member states and other developed countries, farmers have united under the umbrella of various unions and cooperatives to maintain their income and boost their marketing opportunities. In other words, while the state withdraws price support from the sector, the state is replaced by farmer unions and not middlemen. In developed countries, governments already bolster the establishment of these unions with the support they extend (For example, according to a support scheme provided in the EU Budget, any cooperative receives support from the EU for a certain percentage of the total value (turnover) of the products it markets annually, and this support is tax-exempt). However, at this point, the EU has an important condition: Although the shareholders of the unions are farmers, they cannot take part in the management of the union). These unions fulfil great functions for farmers in terms of packaging, transportation, and marketing.

14. Lack of Vision: Main motives that determine agricultural policies in North Cyprus are far from meeting the multi-faceted demands of today's world and only target farmer income. Indeed, there is no legal or technical system in the country that will ensure food safety for consumers and inspect and control every stage of production from farm to

fork. The lack of vision is also visible within the crop patterns. **In today's conditions, a new vision should be adopted in agriculture and especially crop production. For example, global warming negatively affects tomato production in this country in summer, making greenhouse cultivation in winter more feasible. Therefore, how production, exports, and imports are to be handled should be reconfigured within ministerial policies. For example, possible that the country should concentrate in tomato production and export in winter and it should allow importing of tomato in summer... Also, at the core of this new setup should be the needs of the service sector such as tourism.**

15. Support Policies and Incorrect Specialization: The total support levels provided for farmers does not differentiate significantly from countries and organizations such as the EU, OECD, and the US. However, the problem in the agricultural sector of Northern Cyprus is not the size of the support, but the type of support provided. Although different supports are provided for the agricultural sector by means of various public organizations, price support remains the most important support. However, price differentiations that would encourage advantages such as earliness are not applied much in intervention purchases made by various organizations. Most importantly, the most frequently used method of supporting the farmer is price support, which hikes up the prices in the domestic market. **High domestic prices negatively affect the competitiveness of the service sector, which is the driving force of the economy.** As a result of all this, there is a partially wrong specialization in the agricultural production pattern. For example, the share of the fresh fruit and vegetable sector with export potential in production or exports is below what it should be, and the share of the livestock sector and especially cattle breeding is more than what it should be. It should also be noted that **if foreign competition were fully present, it would be highly likely that producers in some sub-sectors would have to shift to other more profitable areas.**

Export Opportunities in the Agriculture Sector

16. Governments intervene in the agricultural sectors all around the world. Today, although the majority of countries try to direct their economies in line with the principles of the free market economy, this does not apply to the agricultural sector. While formulating their agricultural policies, states historically put increase in production at the centre of their targets because of food security concerns. Although

the share of agriculture in national income in developed countries has decreased relatively, this does not mean that the importance of the agricultural sector has waned. **Self-sufficiency in basic agricultural products has been a historical goal in many industrialized countries. This has gained even more importance in the post-pandemic world.**

17. With the 21st century, a new dimension has been added to the formulation of agricultural policies: sustainability of natural resources and the environment. Now, both politicians and relevant technical bureaucrats feel that the objectives chosen while setting agricultural policies must be compatible with the country's natural resources and the environment. In fact, the availability of natural resources, especially water, necessarily influences these policies. Having a much direr impact in recent years, global warming has pushed environmental protection, to which the classical economic doctrines have not paid much attention, more and more into view. In the economic literature, neither socialist economists advocating governmental planning, nor liberals advocating the free market, or Keynesian economists who thought that state intervention is necessary in the economy, did not fully take the environmental phenomenon into account in their economic analyses. Their common concern was to ensure economic growth. However, the side effects of this blessed "growth" phenomenon, especially on the environment, have reached dimensions that cannot be ignored today. Agricultural activity plays an important role in the degradation of the environment and natural resources. As a result of this realization, in today's modern states, relevant state institutions take into consideration the quality of crops from farm to fork and the sustainability of natural resources in addition to the protection of the income of the farmers, which was the main consideration in the 1970s, in setting agricultural policies. However, **this kind of a transformation has not taken place in the agricultural sector in Northern Cyprus.** The sector is still structured with one-dimensional agricultural policy objectives developed in the spirit of the 1970s. In other words, protecting the farmer's income still is the main target of agricultural policies in Northern Cyprus.

18. The historical development of societies indicates that some internal or external shocks experienced in history can play an important role in overcoming problems and in transformation. These shocks can be negative as well as positive. In Northern Cyprus, both positive and negative shocks are/may be experienced. Today, **the bottleneck**

faced by the agricultural sector, budgetary dilemmas, and the inability of the system to produce permanent solutions to the problems can be considered as negative shocks. Likewise, we can consider the water coming from Turkey as a positive shock. The impact of the water is so significant that it can be described as a shock. The reason for this is that water is the most important scarce input in production today. In addition, scarcity of water emerges as the most important problem in the countries with which we share this region, due to global warming and decreasing precipitation. In these conditions, it is necessary to realize the opportunities that water will bring about and accordingly to transform the agricultural sector to maximize the benefits to the country's economy today and in the future.

19. Potential export opportunities in the agricultural sector in Northern Cyprus should be considered in the scenario in which the embargos are being lifted and the country being integrated into the global foreign trade system. However, foreign trade is a two-way road and the issue of possible problems arising in competition with imported goods is not widely discussed in local public. Looking at the problems partially mentioned above and the global developments, the following can be deduced about the sector's foreign trade potential: **There may be an increase in exports only to a limited extent with the current production costs (halloumi, potatoes, greenhouse production, etc.). However, as far as imports are concerned, there may be difficulties in many products, especially meat, dairy products, fruit or processed agricultural products.** These and many similar problems suggest that potential for development in the agricultural sector in terms of foreign trade is limited, and that possible competition-related problems in the domestic market can even prevent opportunities. However, it should be underlined that the water coming from Turkey has the potential to transform many negative factors into positive for competition. Hence, it is clear that the agricultural sector in Northern Cyprus has entered a new phase.

20. To implement new policy proposals and approaches that need to be addressed to increase the export potential in the agricultural sector, it is very important both to respond to the current demands of the domestic market and to maximize the benefits we will derive from international trade. However, it should not be forgotten that **despite all our advantages and the opportunities that water will bring, the agricultural sector has a scale problem. Apart from the scale, the country's natural resources such as soil are**

also very limited, and energy and labour costs are also disadvantageous. All these necessitate directing the use of water to agricultural products with high added value.

21. The high unit costs in small-scale economies such as the TRNC are one of the most important constraints that limit the gains that can be obtained from foreign trade. Therefore, specifically for the TRNC, two main factors emerge to have a competitive advantage in foreign trade in agricultural products: the **advantage of earliness** and the **ability to grow niche products**. Earliness is a very important but limited advantage. It is important because it makes it possible to export the product at the most appropriate time for the market; it is limited because your exports may come to a standstill when the big producers start supplying them to the market. An examination of the experiences of open economies that are integrated with the world and have similar characteristics with the TRNC shows that when large producing countries start to supply, small economies may experience difficulties even in their domestic markets, let alone the drop in their exports. Therefore for small economies, being able to produce and market niche products is very important in terms of maximizing export revenues and ensuring the sustainability of exports.

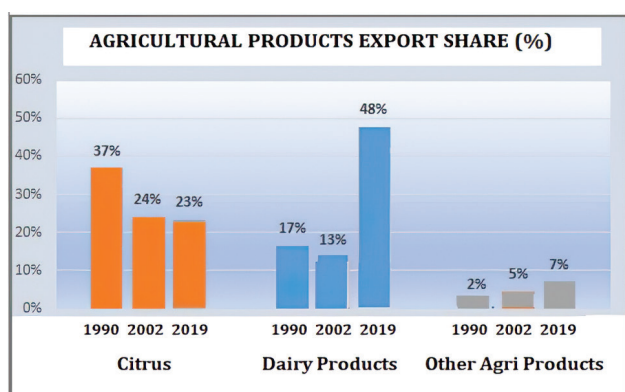
22. Niche products are, so to speak, trendy items both for agriculture and also all areas of economy and have recently become very popular. A fact that should be mentioned about niche products in Northern Cyprus is the characteristics of niche products in the context of marketing. Northern Cyprus is an economy with limited production capacity due to scale constraints. **It is a very costly, laborious, and even risky process to transform a product that is locally known and has a domestic market into a niche product commanding international demand.** When success is achieved in all stages of international marketing, a sustainable foreign trade potential can be achieved for the product in question. Such a difficult process can only be tried out on products with sufficient supply. Otherwise, even if the product ceased to be local and became global, the export would remain symbolic. To summarize, **it is a difficult task to turn a local niche product into a commodity that has appeal for foreign trade, and if it is a product with limited flexibility of supply with symbolic production, it would be a more rational strategy to make use of that product in terms of tourism.**

23. When we think of profitable niche products for Northern Cyprus, the first product that comes into mind is halloumi. However, despite all the support extended to this sector over

the years, the sector is far from producing and exporting the product in accordance with its rules of registration. Similar problems are also true for Southern Cyprus, where strategic plans have been implemented to overcome them. In Southern Cyprus, the relevant ministry has set an objective to increase the supply of sheep and goats by 10% each year and allocated an annual additional investment budget of €70 million in line with this target. Similar programmes urgently need to be launched in the north.

24. A serious increase in cow milk production had been experienced specially after 2004 due to the high amount of support provided for livestock farming. As a result of excess supply of milk at domestic market, exporting the surplus was the only option available. Beside the subsidies provided for producers, freight subsidy provided for exporters created a drastic increase in dairy product exports after 2004 as can be seen from the below graph. Main markets for dairy product exports is Gulf countries and Turkey.

Figure 3.4 Agricultural Products Export Shares Through the years



Source: Ministry of Economics and Energy, Trade Department

25. However, focusing only on halloumi means that the agricultural sector would not fully realize its potential. Our climatic and soil conditions show that we can make a profit if we can produce niche products in many fruit and vegetable species. At the forefront of these products **are organic food products, which constitute one of the fastest developing foreign trade markets today.**

26. Many developed or developing countries today are trying to promote conversion to organic agricultural production more and more intensively. In this process, countries are supporting their producers more intensely each passing day. Logic behind this support are the advantages that organic agriculture provides for countries in terms of social, economic, environmental, and health aspects. In terms of economic advantages, developing countries' opportunities to export

non-organic agricultural products to developed countries are quite limited due to their low competitiveness in intensive agriculture. In other **words, developing countries can hardly enter the EU or the US markets in basic products such as meat, milk, or cereals, and they can obtain this chance of entry only in some fruits and vegetables such as bananas, which developed countries cannot produce in sufficient amounts.** In today's conditions, organic agriculture offers an important opportunity for developing countries, especially due to the economic opportunities provided by the EU, North American or Far Eastern markets, which also enjoy high consumer purchasing power.

Green Line Trade

27. Green line is the most convenient export market in respect of transportation cost due to its proximity. Trade through green line is regulated with EU Commission's Green Line Trade Regulation published back in 2004. According to Regulation wholly produced agricultural products at northern part of the island can cross line as long as they qualify the other provided requirements in terms of plant health etc. Volume of agricultural goods trade is fluctuating from year to year. Potatoes was the leading product traded followed by onion, cucumber, tomatoes, carrot and strawberry but with a quite low volume also influenced by the seasonality of the production.

Table 3.1 Agricultural Product Exports Through Green Line (€000)

| (Thousand €) | 2005 | 2010 | 2015 | 2020 |
|-----------------------|------|------|------|------|
| Fruits and Vegetables | 282 | 600 | 75 | 443 |
| Fish | | 920 | 688 | 636 |
| Total Volume | 1660 | 6000 | 3900 | 4600 |

Source: Turkish Cypriot Chamber of Commerce

28. Content of agricultural trade through Green Line is subject to high level of regulations arising from the EU agricultural legislation (health and sanitary etc). For example the recent change that brought the requirement of plant health certification for the fresh vegetable trade halted the trade of this group of products. A new authorization is required and expected to be implemented in order to restart the trade of fresh vegetables and fruits across the island.

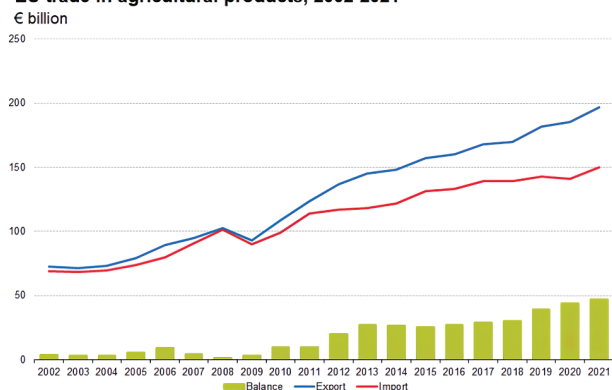
29. Processed agricultural product trade is also subject to similar constraints and conditions. Trade of dairy products is

completely banned at the moment due to the non harmonized animal health situation in the Northern Cyprus. However the trade of fish and recently trade of honey is enabled with the satisfying conditions required. For the trade of both raw products and processed agricultural products there is a need for upgrading the quality level of products as well an authorization of local institutions to certify the products wholly produced in Northern Cyprus. Green line trade offers quite high potentials for the agricultural production as long as it is harmonized with the required conditions and standards.

EU Market

30. Foreign trade structure of the EU market in agricultural products, which is of great interest to us, is as follows: For 2021, the EU has a **foreign trade surplus of approximately €47 billion** in agricultural products. However, the most important point to be noted is that this surplus is in an increasing trend, that is, the EU is becoming more and more a net exporter of agricultural products.

EU trade in agricultural products, 2002-2021



Source: Eurostat (online data code: DS-045409)

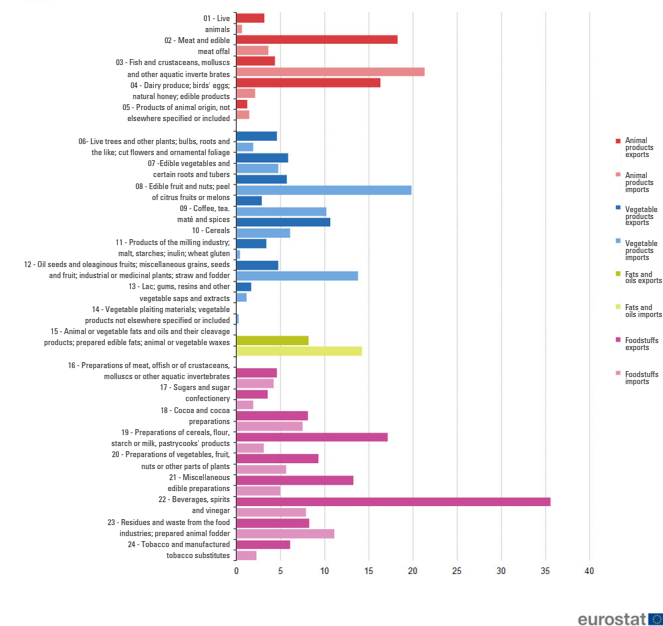
eurostat

31. When the foreign trade structure of the EU market is examined in more detail, it is seen that €47 billion of surplus obtained from the foreign trade of agricultural products in 2021 was obtained from two of the three basic subgroups. In other words, while the EU has a foreign trade surplus in animal products and various (processed) foodstuffs, it has a foreign trade deficit in crop (vegetable) products. As can be seen from the figure below, this deficit is mostly in the fresh fruit-vegetable category.

Global Organic Market

32. Today, with the rise in consumer awareness of the close relationship between human health and foods consumed, the demand for organic products is increasing rapidly. Although such demands date back to the 1970s in developed countries, it

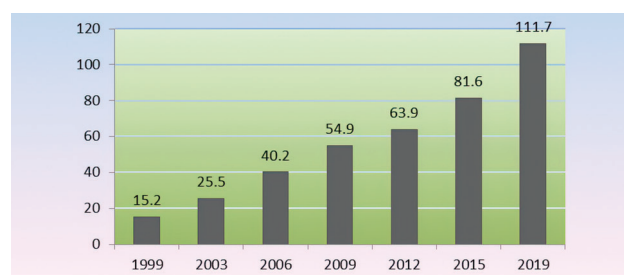
EU Agricultural exports and imports by product categories, 2021



eurostat

has gained momentum with the turn of the current century and this momentum is speeding up day by day. In the past, organic products were solely a 'niche market' that was only of interest to a small number of conscious and marginal customers; however, they have ceased to be such an enormous market in recent times and turned into a social phenomenon. In the 1980s organic products were only used for baby food and many consumers were not very much aware of them, and did not have international demand. **By 2019, organic products turned into a huge market of nearly \$112 billion.**

Figure 3.4: Global Organic Market (bn, \$)



Source: IFOAM, 2022 Database.

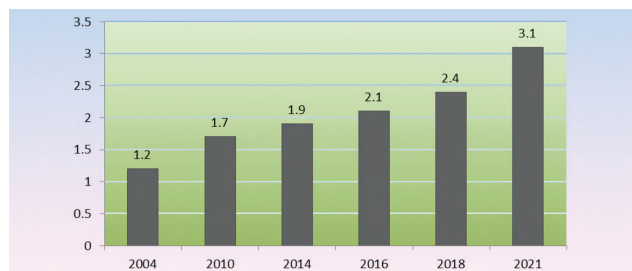
33. The fact that most demand for organic products in the world comes from developed countries with high purchasing power and a stable demand is another factor that attracts the attention of all countries that wish to increase their export potential and volume in food. In other words, considering the size and development potential of the global market for organic food, great opportunities await the countries that can offer such products. The reason is that there is an excess demand (shortage of supply) in all organic products. Furthermore, a quick look at the rate of increase in demand and supply shows

us that it is not easy to close this gap in the near or medium term. **Since the increase in demand is constantly above the increase in supply, the gap, let alone decreasing, is getting even wider today after the pandemic.**

UK Market

34. One of the markets where organic agriculture is developing very rapidly is the UK market. The importance of this market for the TRNC is indisputable. Traditional commercial ties and the size of the Cypriot population there have always made this market a priority for both Turkish Cypriots and Greek Cypriots. In addition, the post-Brexit period has given UK the opportunity to revive its commercial relations independently from the EU. The organic market in the UK reached a size of approximately £3.1 billion by 2021.

Figure 3.5: Development of the UK Organic Food Market (bn, £)



Source: "UK Organic Market Report, 2022" www.soilassociation.org

35. An interesting feature of the UK market is that the development trend of the non-organic food market (including processed agricultural products) has remained stable over the last decade and even experienced negative values in some product in previous years. Despite the population growth and economic development, organic food products successfully replace the gap in this market. While the organic market grows 5 to 6% on average every year for the last couple of years, the growth figure was 13% in 2019.

36. The main product groups of the UK organic market are dairy products, packaged food groups including fruit and vegetables, herbal teas etc. For example, by 2021, the size of the organic dairy market in the UK reached £500 million. Organic yogurt, one of the most important products in this segment, constitutes approximately 40 percent of this market. One out of every ten yogurts sold in today's market is organic

37. The new trends in the UK organic food market show that plant-based foods derived from soy or oat, various vegan products (food supplements), probiotic foods such as kefir or yogurt, energy bars etc. are becoming popular. In addition to

food, organic cosmetics and personal care sectors are among the fastest growing markets in the UK.

Republic of Turkey Market

38. Developments on the supply side are especially noteworthy in Turkey's organic market. For example, the area where organic cultivation is carried out went from approximately 90 thousand hectares to 650 thousand hectares in the last two decades, and Turkey has risen to the 18th place in the world in this area. The rise in the number of certified farmers, which went from 12,500 in 2002 to 43,700 in 2012, and then to 74,545 in 2019, is even more striking. Turkey ranks 7th in the world and first in Europe in this parameter.

39. Despite the developments on the supply side, the size of the domestic market cannot even reach 100 million euros; that is, it is far below its potential. While countries such as Denmark have exceeded 300 euros/year in per capita organic expenditure, this figure is still around 1 euro for Turkey.

40. Turkey is foremost a net exporter of organic produce. The primary unprocessed agricultural products in Turkey's limited import of organic produce are soybeans, dates, flaxseeds, sesame seeds, oat, dried plums-apples, etc. **On the production and export side, the development is much more striking.** While certified farming was carried out just for a few products in the 1990s, 250 different types of products are produced today. In terms of quantity, production has increased from about 500 thousand tons in the last ten years to 2.5 million tons today. For example, Turkey has succeeded in converting 30% of its tropical and sub-tropical fruit cultivation areas (20 thousand hectares) into organic production. This proportion is 9.5% (83 thousand hectares) for olives and 3.6% (15 thousand hectares) for grapes. Likewise, Turkey, along with Russia and Ukraine, is one of the three largest exporters of organic grains imported by the EU. Another area where the country is a big player is organic cotton. 10% of the world production takes place in Turkey (the third largest producer after India and China). Currently, Turkey exports organic products to more than 40 countries. **The EU imports 25% of its citrus, 26% of its fruit juice and 17% of its vegetables from Turkey. Today, 6.5% of the EU's total imports (in terms of quantity-tons) comes from Turkey. Fresh fruits and vegetables, which will be determined by using the earliness advantage of Northern Cyprus, will also be able to be determined as a target for the Turkish market.**

Northern Cyprus: What To Do?

41. Considering the importance of organic agriculture for the TRNC, as explained in the previous sections, there is a scale problem in the TRNC agriculture sector, both in crop cultivation and livestock production. Considering that we are a small island economy, it is not possible for this problem to disappear completely. For the small-scale farmers that make up the sector in general, organic agriculture emerges as an alternative source of income with high earnings. High unit costs, which are the most important constraints of small to average-sized enterprises, prevent the sustainability of such businesses and their earnings from trade. However, the fact that organic products are marketed with a significant price difference compared to conventional products offers economic opportunities to small businesses in the TRNC as in all developing countries.

42. In light of the fact that the competition in international trade is very intense and getting more intense every day, it appears that it would only be possible for Northern Cyprus producers to profit from halloumi or niche organic products in the EU market, which is dominated by countries such as the Netherlands and Denmark, which are many times higher than Northern Cyprus in terms of average business size and output. The most important factor to be noted here is that the EU is the most important region in the global organic market of \$112 billion. Considering the fact that the EU has a very significant supply gap in the organic market for all products and the current production growth rates, it is clear that there are great opportunities in this field within the EU market. Another important factor that positively affects market entry is that **no tariff and non-tariff barriers are applied to organic products.**

43. Another advantage of organic agriculture for the TRNC is that the certificates indicating that the products are organic are not issued by states, but by internationally recognized certification bodies. According to the existing laws, countries **are obliged to recognize the product certificates issued by accredited certification bodies. This emerges as a window of opportunity where a country like the TRNC, which is facing recognition problems, can create opportunities even in existing conditions. At this point, it should also be underlined that organic products produced in the TRNC have a high export potential also through the green line trade as well.**

44. As it can be understood from the above, implementing various disjointed and incompatible measures to develop organic agriculture would only lead to a symbolic development of the sector, as seen in the TRNC example. The experiences

of the countries that have come a long way in this area show that these goals can only be achieved by effective planning, support, and the guidance of public policies together with integrated strategies. Therefore, the TRNC Ministry of Agriculture must go beyond the 1970s-80s, develop macro and micro strategies, and ensure the development of the sector and take the agricultural sector towards new horizons. **Continuing to use the water coming from Turkey on the same crop patterns by insisting on current policies would only mean not being able to realize the potential in Northern Cyprus that comes about with the water and hence ignoring the opportunities in foreign trade. Therefore, the relevant ministry should put new visions in the crop patterns at the core of its policies and intensively encourage the cultivation of new internationally demanded products such as avocados. It should not be forgotten that economy is dynamic and new trends have always come and go as they will in the future. The only way to gain the highest level of profit from trade opportunities is to direct the factors of production to these rising trends.**

45. The pandemic that affected the whole world in 2020 and the post-pandemic developments show that the agricultural sector, as all others, has evolved at both the global and local levels. The primary effect of the pandemic on agriculture was the disruption in the supply chain. During this period, the problems experienced in the supply of seasonal workers and in the import of various inputs and the decrease in the marketing (sales) capacity were identified as the primary issues. As a result of these and similar problems, the costs increased, and inevitably excessive volatility was experienced in market prices. **To reduce the impact of this period and to ensure the continuation of agricultural production, an additional 157 billion worth package of measures, the majority of which was implemented in developed countries, was put into effect only in 2020.*** Most of this amount consisted of actions to ensure the continuity of production, such as cost-reducing measures and extension of suitable loan packages to producers. In 2021, these stimulation packages were continued, and policies were implemented to boost the durability of the sector in addition to ensuring the continuity of production.

46. On top of the problems caused by the pandemic, the Russia-Ukraine war and related supply shocks of 2022 severely disrupted the functioning of the global agricultural market as well. Today, an extraordinary uncertainty prevails in basic agricultural products and inputs, especially in

* "Agriculture and Food Policy Responses to the Covid 19 Crisis", OECD Report, 2021.

terms of accessibility and affordability. This increases the risk perception of the players in the sector excessively. **At the moment we are going through a time when the price mechanism and pricing behaviour, which is the most important element of the free market economy, has completely deteriorated. As a result of all these developments, the largest price increases in recent periods have been observed in global agricultural markets. The world today is faced with supply shocks, stagflation risks and immense food crisis. It is obvious that all these developments will have enormous economic, social, and humanitarian impacts on the people. The extent of the damage will be determined by the governments that control the country's economy.**

APPENDIX I

A1. Economic Assessment Survey Questionnaire (See Turkish version)

APPENDIX II

A2. Methodology for the Measurement of Transformation Readiness

Since the value of each indicator used in scoring has a different unit and content, each indicator value was converted into a score out of 100 by using the formula below. After the 64 indicator values under a total of 11 priority areas were converted into scores out of 100, the arithmetic averages

were found to reach the priority scores, and then the overall country score out of 100 was found with the sum of the scores obtained. The countries' transformation readiness scores were calculated, with the lowest score being 0 and the highest score being 100.

$$\text{Indicator Score}_{i,c} = (\text{Value}_{i,c} - \text{Min}_i / \text{Max}_i - \text{Min}_i) \times 100$$

Value i,c means Indicator value i for country c

(Min i) means the lowest possible value of the indicator i

(Max i) means the highest possible value of the indicator i .

Using the formula above, if the relevant indicator of country c is the lowest among the other countries', the relevant indicator score is set as 0, while if the relevant indicator of the country has the highest value among other countries', the indicator score is calculated as 100. Indicator values obtained through

the survey were scored between 1 and 7, as in the previous methodology. Values between 1 and 7 given by businesspeople in the Executive Opinion Surveys were also converted into 100 points using the above formula after calculating a value over 7 by means of simple arithmetic mean.

APPENDIX III

A3. Priority Area Scores of Countries

| Country/Economy | Ensure public institutions embed strong governance principles and a long-term vision and build trust by serving their citizens | Upgrade infrastructure to accelerate the energy transition and broaden access to electricity and ICT | Shift to more progressive taxation, rethinking how corporations, wealth and labor are taxed, nationally and in an international cooperative framework | Update education curricula and expand investment in the skills needed for jobs and “markets of tomorrow” | Rethink labor laws and social protection for the new economy and the new needs of the workforce | Expand eldercare, childcare and healthcare infrastructure, access and innovation for the benefit of people and the economy |
|-----------------|--|--|---|--|---|--|
| Argentina | 45.4 | 67.6 | 52.9 | 46.9 | 59.5 | n/a |
| Australia | 66.7 | 73.0 | 62.1 | 63.5 | 64.7 | 49.6 |
| Austria | 69.9 | 83.8 | 49.9 | 60.6 | 66.4 | 42.8 |
| Belgium | 62.7 | 82.7 | 54.0 | 65.8 | 71.1 | 54.9 |
| Brazil | 45.3 | 79.4 | 44.0 | 39.5 | 51.0 | n/a |
| Canada | 67.0 | 77.0 | 56.7 | 65.3 | 69.8 | 61.6 |
| Chile | 61.9 | 72.1 | 52.0 | 52.1 | 51.6 | 48.7 |
| China | 64.3 | 77.5 | 58.1 | 67.0 | 64.4 | n/a |
| Czech Republic | 56.3 | 81.6 | 46.8 | 48.5 | 63.1 | 40.0 |
| Denmark | 72.0 | 91.5 | 41.8 | 71.5 | 77.0 | 65.0 |
| Estonia | 66.5 | 99.7 | 41.4 | 56.8 | 62.8 | 47.0 |
| Finland | 78.5 | 88.9 | 43.9 | 75.3 | 71.1 | 61.4 |
| France | 64.0 | 82.6 | 55.6 | 56.8 | 66.7 | 52.7 |
| Germany | 66.5 | 79.6 | 54.2 | 61.4 | 74.0 | 51.4 |
| Greece | 46.3 | 80.8 | 42.6 | 38.7 | 47.6 | 24.7 |
| Hungary | 46.1 | 86.4 | 30.70 | 40.8 | 53.7 | 34.4 |
| India | 49.4 | 72.6 | 55.8 | 43.5 | 44.4 | n/a |
| Indonesia | 58.8 | 67.7 | 53.7 | 49.0 | n/a | n/a |
| Ireland | 65.6 | 86.8 | 59.2 | 59.5 | 62.8 | 45.8 |
| Israel | 65.4 | 74.2 | 49.6 | 66.6 | 57.9 | 56.8 |
| Italy | 49.6 | 74.1 | 39.1 | 40.7 | 55.6 | 37.0 |
| Japan | 65.9 | 76.9 | 64.5 | 51.3 | 61.5 | 49.3 |
| Korea, Rep. | 62.2 | 81.8 | 63.4 | 60.0 | 61.2 | 48.5 |
| Mexico | 44.3 | 75.0 | 48.8 | 43.3 | 49.2 | 36.1 |
| Netherlands | 72.0 | 91.4 | 47.3 | 71.8 | 71.9 | 61.2 |
| New Zealand | 73.0 | 68.1 | 53.5 | 63.5 | 67.5 | 58.6 |
| North Cyprus | 33.8 | n/a | n/a | 31.9 | 56.2 | 34.9 |

| Country/Economy | Ensure public institutions embed strong governance principles and a long-term vision and build trust by serving their citizens | Upgrade infrastructure to accelerate the energy transition and broaden access to electricity and ICT | Shift to more progressive taxation, rethinking how corporations, wealth and labor are taxed, nationally and in an international cooperative framework | Update education curricula and expand investment in the skills needed for jobs and “markets of tomorrow” | Rethink labor laws and social protection for the new economy and the new needs of the workforce | Expand eldercare, childcare and healthcare infrastructure, access and innovation for the benefit of people and the economy |
|---------------------------|--|--|---|--|---|--|
| Poland | 46.7 | 77.8 | 33.6 | 41.9 | 59.8 | 30.3 |
| Portugal | 57.8 | 87.8 | 52.1 | 49.8 | 58.1 | 31.4 |
| Russian Federation | 42.8 | 57.2 | 49.8 | 44.9 | 65.0 | n/a |
| Slovak Republic | 50.0 | 84.9 | 44.4 | 46.5 | 58.7 | 35.5 |
| South Africa | 53.9 | 63.8 | 65.2 | 42.6 | 42.9 | n/a |
| Spain | 56.4 | 86.9 | 49.0 | 51.4 | 59.7 | 45.3 |
| Sweden | 70.3 | 88.0 | 45.9 | 69.4 | 63.7 | 75.9 |
| Switzerland | 76.8 | 80.0 | 41.5 | 70.8 | 74.2 | 51.3 |
| Turkey | 47.7 | 67.1 | 40.7 | 39.8 | 48.4 | 32.3 |
| United Kingdom | 65.7 | 80.9 | 54.1 | 59.7 | 75.2 | 50.4 |
| United States | 67.5 | 71.2 | 52.8 | 68.2 | 56.9 | 54.2 |
| Mean | 60.0 | 78.7 | 50.0 | 55.3 | 61.4 | 47.8 |
| Standard Deviation | 10.23 | 8.98 | 8.14 | 11.19 | 8.88 | 11.78 |
| Highest Score | 78.47 | 99.75 | 65.16 | 75.26 | 76.98 | 75.87 |
| | Finland | Estonia | South Africa | Finland | Denmark | Sweden |
| Lowest Score | 42.84 | 57.21 | 30.72 | 38.75 | 42.90 | 24.73 |
| | Russian Federation | Russian Federation | Hungary | Greece | South Africa | Greece |