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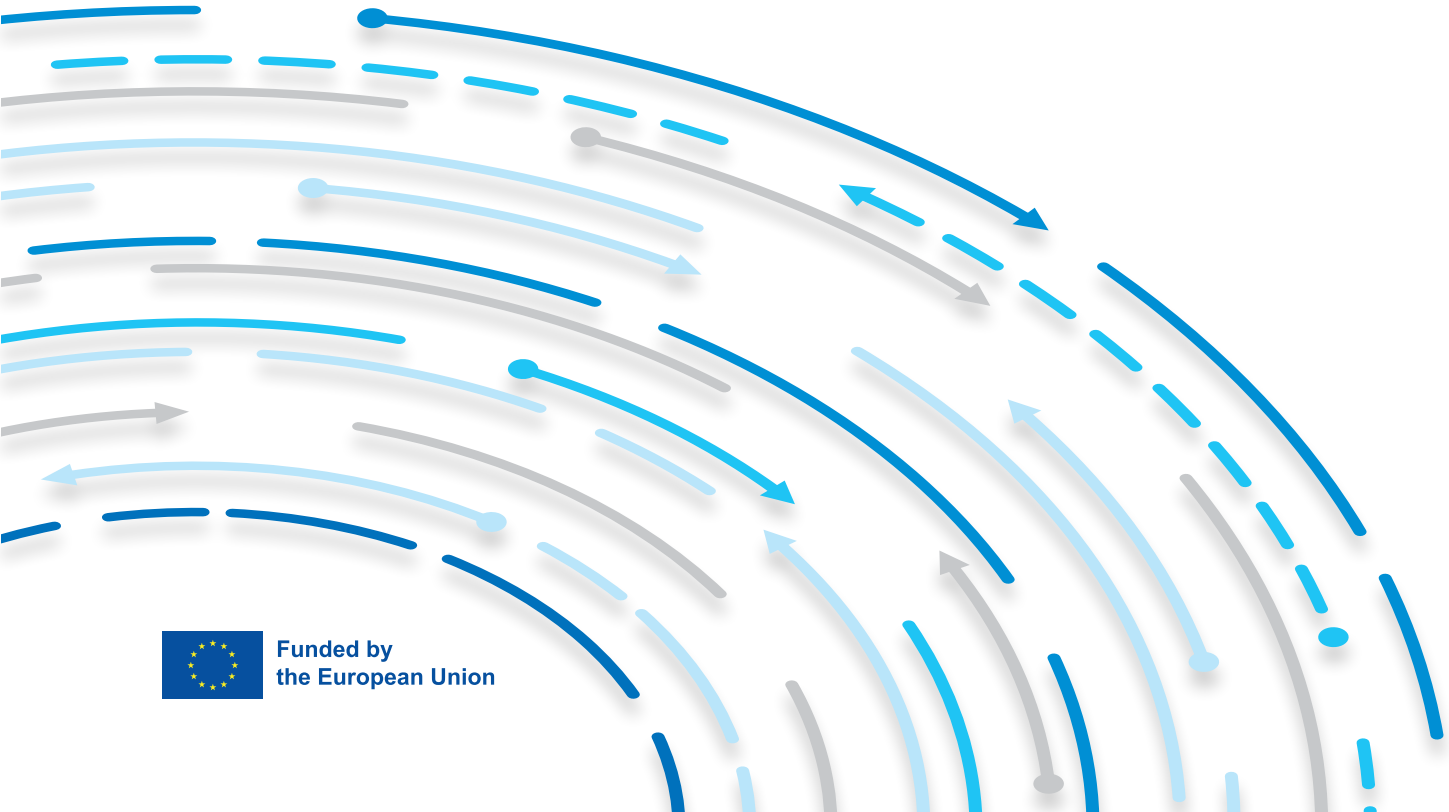
Turkish Cypriot Economy

Beyond Bottlenecks: Fostering Economic Integration

A Macroeconomic Monitoring Note

Special Issue: **Unlocking Trade Potential**

June 2025



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Acknowledgements

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The team is grateful to Jasmin Chakeri (Practice Manager, World Bank) and Annely Madeleen Koudstaal (Program Manager for Southern Europe, World Bank) for their guidance throughout the preparation of this report. Special thanks are also due to the peer reviewers, Albert Pijuan Sala (Senior Economist) and Shane Sela (Senior Trade Facilitation Specialist), for their insightful comments and feedback.

Valuable support in data collection and coordination with local counterparts was provided by İzge Arısal (Local Technical Coordinator, World Bank) and Suay Anıl (Consultant, World Bank). The team also acknowledges Fiona Jean Hinchcliffe for her editorial assistance.

The team appreciates the constructive feedback from Oya Koçak Barçın (Programme Manager, European Commission), and the ongoing support of Betül Atasayan Gülseven and Tuğyan Atıfsoy of the European Union Coordination Centre.

Lastly, the team acknowledges the close collaboration with the local bodies in the Turkish Cypriot community and thanks the business chambers for their active engagement, including the Turkish Cypriot Chamber of Commerce, the Turkish Cypriot Chamber of Industry, the Turkish Cypriot Chamber of Shopkeepers and Artisans, and the Turkish Cypriot Union of Banks.

Abbreviations and Acronyms

CAR	Capital Adequacy Ratio
CBRT	Central Bank of Türkiye
COF	Cost, insurance and freight
CPI	Consumer Price Index
ECA	Europe & Central Asia
ERPT	Exchange rate pass-through
EU	European Union
EUR	Euro
FOB	Free on board
FX	Foreign Exchange
GC	Greek Cypriot
GCc	Greek Cypriot community
GCe	Greek Cypriot economy
GDP	Gross Domestic Product
HS	Harmonized Commodity Description and Coding System
NPL	Non-performing Loan
NTM	Non-tariff Measure
ROAA	Return on Average Assets
ROAE	Return on Average Equity
RoC	Republic of Cyprus
RoC GCA	Republic of Cyprus Government-Controlled Area
SPS	Sanitary and Phytosanitary
TC	Turkish Cypriot
TCc	Turkish Cypriot Community
TCe	Turkish Cypriot Economy
TL	Turkish Lira
yoy	Year-over-year

Executive Summary

This edition of the Macroeconomic Monitoring Report (MMR) for the Turkish Cypriot economy (TCe) brings together two interrelated parts. Part I provides analyses on recent economic developments, including growth, trade, fiscal performance, and financial sector developments, based on the latest data available, part of it through to early 2025. This section sets the stage by outlining the key developments and risks shaping the current economic environment. Building on this foundation, Part II presents a Special Issue on unlocking trade potential, zooming in on one of the structural constraints highlighted in Part I: the high cost and limited scope of trade. By combining a short-term macroeconomic overview with an in-depth exploration of a medium-term policy challenge, the report offers a more complete picture of the constraints and opportunities facing the TCe. It is intended as a practical tool for both local bodies and the business community to identify concrete, actionable steps that can help unlock economic potential, deepen economic integration on the island, and strengthen resilience in a complex and uncertain environment.

The Turkish Cypriot economy (TCe) grew strongly in 2024, by an estimated 6.4 percent in real terms. Growth was driven by domestic consumption, fueled by expansionary 'public' wages and private sector salary adjustments to rising living costs. However, the contribution of consumption was dampened by persistent inflation and depreciation of the Turkish Lira, which outpaced wage increases. Net merchandise 'exports' contributed negatively to growth, as TCe's sales to Türkiye declined by 13.2 percent. Services remained a key growth driver but showed signs of deceleration owing to a slowdown in 'tourist' arrivals.

Exchange rate fluctuations pass through to inflation in the TCe, due to its heavy reliance on 'imports' and the absence of independent monetary policy. The Turkish Cypriot community's (TCc) reliance on the Turkish Lira and the lack of independent monetary policy deprives the economy of an important economic policy lever. The Central Bank of Türkiye (CBRT) launched a monetary tightening cycle in June 2023, extending through to November 2024, after which interest rates began to ease. This helped to stabilize the exchange rate, containing further inflationary pressures. As a result, inflation in TCe fell from 83.63 percent in December 2023 to a still high 53.29 percent by the end of 2024.

Inflation in 2024 was also the result of domestic factors, including increased wages, elevated cost of 'imports', and structural constraints. These include increased production costs, particularly due to a growing wage bill and surging aggregate demand. The inflationary impact is felt disproportionately by poor and vulnerable households, who spend around two-thirds of their income on essential goods and services.[1] Furthermore, the elevated cost of 'imported' goods, which constitute the bulk of consumption in the TCe, has intensified inflation.

Inflationary pressures are exacerbated by high 'trade' costs in an economy heavily reliant on imported goods (see Special Issue of this report). These costs raise consumer prices and input expenses for domestic firms, undermining productivity and competitiveness—challenges that are particularly relevant in a small, open economy like the TCe. Affordable access to imported inputs is critical for TCe firms to adopt higher-quality intermediates, especially from high-income countries, and to improve the quality of their exports. At the same time, these challenges represent an opportunity to further strengthen economic integration on the island. Targeted policies that lower both direct and indirect 'trade' costs and promote stronger cross-community economic linkages can deliver shared benefits, reinforcing resilience and expanding market opportunities across the economies.

1 TC Statistics Office, Household Budget Survey, 2022.

Green Line (GL) crossings—an important indicator of demand for services in the TCe [2]—saw a slowdown compared to 2023, falling from 17 percent growth to only 1.2 percent. Turkish Cypriots accounted for the largest share of crossings, while crossings by Greek Cypriots and other visitors declined. The declining trend in arrivals to TCc and GL crossings can largely be attributed to adverse economic developments in the TCe, especially persistently high inflation.

'Fiscal' pressures remain elevated, with total 'public' expenditures rising from 29.2 percent of GDP in 2023 to 35.4 percent in 2024, outweighing 'fiscal' revenue growth. This surge was mainly driven by growth in current transfers, wages and compensation, followed by significant increases in other current and capital expenditures. As a result, the 'fiscal' deficit widened considerably, from 0.9 percent of GDP in 2023 to an estimated 4.1 percent in 2024.

While the TC banking system remains resilient, growing lending and currency-related risks warrant close monitoring. Gross loans rose by 41.2 percent in 2024, driven by an increase in working capital loans for corporations and consumer loans for households. A falling share of deposits in foreign currencies combined with a rising share of foreign currency loans could heighten currency mismatch risks and expose the banking system to indirect systemic vulnerabilities. Although non-performing loans (NPLs) have fallen overall, NPLs in the construction sector increased to 20.1 percent in 2024. With construction—a key driver of economic activity in recent years—showing signs of a slowdown, any further deterioration could increase the share of NPLs in this sector and affect asset quality within the banking sector.

Risks continue to be significant due to uncertainties over future economic developments affecting the services and construction sectors. Trade uncertainties and 'export' market fluctuations could harm corporate performance, particularly in services like tourism. A slowdown in the construction industry, reduced investments, and rising reputational risks[3] may strain construction companies' balance sheets, increase non-performing loans, and weaken banks' financial health.

Special focus on realizing untapped trade potential

Realizing the potential for greater trade integration across the GL could help promote the competitiveness of the TCe. For the purposes of this report, unless otherwise stated, transactions from the TCe to the GCe will be referred to as the GLT. A special focus section in this report explores the extent of unrealized trade potential across the GL and the impact of regulatory restrictions on trade integration between the TCe and Greek Cypriot economy (GCe). The analysis reveals significant underutilized potential for GLT, both in terms of volume and product variety. It identifies key obstacles—primarily sector-specific non-tariff measures—and emphasizes the need for regulatory and investment climate reforms to enhance the TCe's competitiveness and facilitate closer trade integration on the island.

Currently, the potential of Green Line trade (GLT) remains underutilized, representing only an estimated 10 percent of total sales from TCc to other markets. GLT volumes declined by 2 percent in 2024[4], following three consecutive years of growth. A set of local restrictions significantly hampers the amount and type of trade across the GL. For instance, the RoC does not authorize the crossing of all processed food products of non-animal origin due, allegedly, to food safety concerns. The TCe also applies similar restrictions on goods crossing to the TCe from the GCe. Moreover, VAT must be paid on goods from the GCe twice, once in the government controlled areas of the Republic of Cyprus and a second time upon arrival in the TCc, and

2 GL crossings act as a high-frequency indicator of cross-communal economic activity, reflecting changes in consumer demand, commercial transactions beyond the Green Line Trade (GLT), and the utilization of services within the Turkish Cypriot economy.

3 The issuance of international arrest warrants and the conviction of at least three EU citizens for their involvement in property development transactions on disputed land in TCc have intensified legal uncertainties and attracted international attention. These events highlight the complex nature of property rights in the region, which could undermine investor confidence and affect the wider economic landscape.

4 GLT statistics published by TC Chamber of Commerce, https://www.ktto.net/2004-2024-satislar/.

it cannot be rebated in either case, which makes GC goods expensive. Most goods from the GCe can also only be traded from the GCe to the TCe once a license or permit has been issued.

Other restrictive trade measures continue to suppress trade between the TC and the GC economies. For example, the analysis in the current report finds that most goods entering the TC market from the GCe and other economies are subject to pre-permit requirements—unlike in the EU, where compliance is typically checked at the point of entry. The efficiency and effectiveness of pre-permits is questionable, yet they increased in number from 64 in 2010 to 180 in 2020. The findings also show that the TCe consistently pays significantly higher prices for goods entering the TC market than comparable economies in the region. This price wedge—ranging from 10 to 22 percent—is not fully explained by product quality or sourcing pattern, but is strongly linked to non-tariff measures (NTMs), including 'import' licenses and product specific rules.

The analysis also shows that 'regulatory' intensity in the TCc remains consistently highest in key sectors such as agriculture and food. These sectors not only face a denser layering of overlapping NTMs, such as 'import' licenses and pre-permits, but also encompass the widest range of goods arriving from the GCe. This confirms that price differentials are shaped not only by economic factors or product composition, but also by targeted 'regulatory' practices that disproportionately raise prices of goods entering the TCc market in strategically important sectors. Certain NTMs are especially distortionary, including licensing requirements and monitoring or surveillance measures. While some NTMs may serve legitimate policy objectives, their impact highlights the need for a comprehensive regulatory review. Streamlining, simplifying or removing redundant measures, notably those with limited technical justification, could lower trade costs, improve access to a broader range of suppliers, and enhance the overall competitiveness of the TCe.

The TCe could supply the GCe and broader EU markets with a greater volume and range of goods, including processed and unprocessed foods, which are currently supplied from elsewhere. Closing the persistent gap between actual and potential GL trade flows highlighted by the analysis requires not only regulatory reforms—but also targeted investments in productive capacity, logistics, standards infrastructure, and access to market information and 'export' finance. A credible, mutually supported political initiative is essential to reduce trade frictions, build investor confidence, and deepen economic and social integration across the GL, delivering economic benefits to both communities.

Outlook and recommendations

The economic outlook for 2025 weakens, subject to global trade uncertainty and downside risks remain. Growth of the TCe is expected to moderate to around 4.2 percent in 2025, reflecting weaker external and domestic demand, persistent and high inflation, and fiscal pressures. On the demand side, consumption is projected to be the key driver of growth, supported by cost-of-living adjustments, while investment is set to decline due to reduced construction activity, owing to limited domestic resources and lower external financing from Türkiye. Net sales to third countries and the GCe are projected to weigh on growth amid weaker demand from key partners like Türkiye and the GCc alongside global trade uncertainty. However, lower global demand and declining oil prices could ease energy costs and slow 'import' growth. On the supply side, services, particularly tourism, will support growth, while construction is expected to act as a drag due to slowing activity, weak real estate demand, and ongoing reputational issues.[5]

The evidence presented in this report, particularly in the Special Issue on trade, underscores that despite constraints, there are real and actionable opportunities for progress. Reducing trade frictions,

5 The issuance of international arrest warrants and the conviction of at least three EU citizens for their involvement in property development transactions on disputed land in TCc have intensified legal uncertainties and attracted international attention. These events highlight the complex nature of property rights in the region, which could undermine investor confidence and affect the wider economic landscape.

improving the investment climate, and strengthening competitiveness are not only necessary but also achievable. Priorities include: simplifying or removing outdated import licenses and pre-permit requirements, especially in agriculture and food; improving regulatory transparency through a centralized portal; introducing risk-based controls at border entry points; aligning quality standards with the EU; and facilitating access to market information, export finance, and logistics. These reforms would help lower costs for consumers, expand choices, and increase the resilience of domestic firms. While much of this agenda requires actions to be put in place by the local bodies, the private sector has a critical role to play. Businesses are not passive observers—they can adapt to higher standards, invest in compliance and quality, and help shape practical solutions by effective public policy advocacy. This report is intended as a tool for both private sector stakeholders and policy makers to identify concrete ways forward and seize opportunities for progress—even within a complex environment.

The analysis points to a set of options that could deliver shared benefits and strengthen economic convergence:

- Enhancing mutual cooperation between the GCc and TCc to improve quality standards in line with EU requirements.
- Simplifying licensing requirements and replacing outdated pre-permit systems in the Turkish Cypriot community with risk-based controls at entry points and an efficient market surveillance mechanism.
- Streamlining further risk management efforts in the government-controlled areas of the Republic of Cyprus (RoC GCA) for goods crossing the GL, including by introducing a “Green Lane” to further improve crossing time.
- Introducing in the TCc a pilot rewards program to encourage better compliance and improve trade efficiency.
- Eliminating in the TCc unnecessary licenses and pre-permits to bring economic and administrative benefits, lower compliance costs, speed up procedures, reduce product prices and improve local productivity and innovation.
- Making regulatory requirements more transparent through a centralized, user-friendly online portal to improve accessibility and compliance in both the RoC GCA and the TCc.
- Strengthening quality infrastructure, aligning standards, and improving access to market information and finance, especially for firms seeking to enter new EU markets.

Part I Recent Economic Developments and Outlook

1.1 The Turkish Cypriot economy has seen robust growth despite various challenges

Economic growth in the European Union (EU) is gradually gaining momentum, reaching an estimated 0.9 percent in 2024, from 0.4 percent in 2023. This recovery was supported by a moderate increase in private consumption, reflecting higher levels of employment and real income growth as inflation receded. However, 'exports' recovered more slowly than expected due to subdued external demand, particularly from China.

In the Greek Cypriot economy (GCe), growth is estimated to have reached 3.4 percent in 2024, up from 2.6 percent in 2023, underpinned by strong household consumption and investment growth, supported by positive developments in the construction industry. Moreover, strong external demand for services exports, particularly in tourism and maritime transport, has boosted overall 'export' performance.

In Türkiye, economic growth slowed to 3.2 percent in 2024, from 5.1 percent in 2023. Economic activity moderated, particularly in the second and third quarters of 2024, due to a tight monetary and fiscal policy stance. The growth contributions of consumption and investment hit their lowest levels, leaving net exports as the main driver of growth. Despite a decline in consumer prices since May 2024, largely due to a significant base effect, annual average inflation remained elevated at 58.5 percent.

The Turkish Cypriot economy (TCe) expanded strongly in 2024, at an estimated 6.4 percent, following double-digit growth in 2022 and 7.3 percent in 2023 (Figures 1.1 and 1.2). Growth was driven by domestic consumption, fueled by public wage and private sector salary adjustments to rising living costs. However, the contribution of consumption was dampened by persistent inflation and depreciation of the Turkish Lira, which outpaced wage increases. Net merchandise 'exports' to third markets contributed negatively in 2024. While TCe's 'export' of goods to Türkiye, a key trading partner[6], fell by 13.2 percent, merchandise

Figure 1.1 The TC economy saw strong growth in 2024

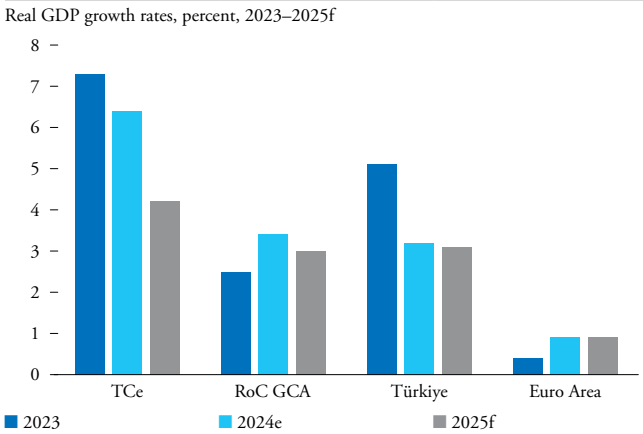
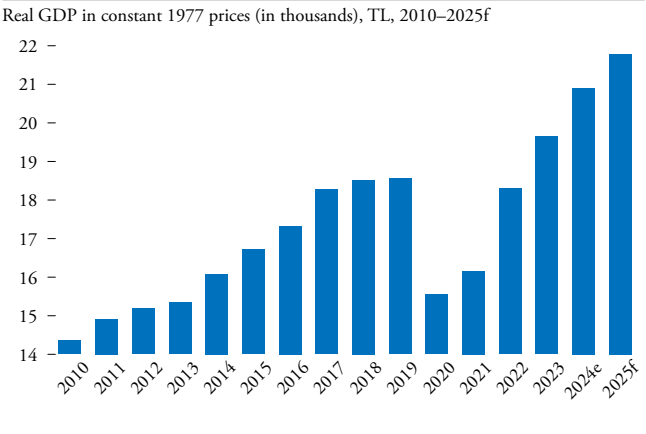


Figure 1.2 GDP maintains its upward trend



Source: World Bank staff estimates, TCc 'statistics office', EC Spring Forecast, 2025.
Note: e=estimated; f=forecast; TCe=Turkish Cypriot economy; RoC GCA=Republic of Cyprus Government-Controlled Area.

6 In 2023, share of Türkiye in total sales of goods rose significantly to approximately 80 percent, up from 54 percent in 2022.

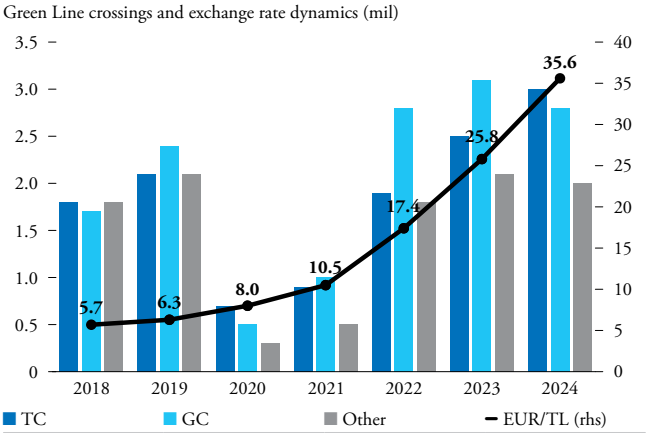
'imports' from Türkiye rose about 10 percent year-over-year (yoy) in nominal terms. On the supply side, services remained a key growth driver but showed signs of slowing. After strong growth between 2021 and 2023, the construction sector slowed amid market saturation, affordability issues, legal uncertainty, and declining investor sentiment.

The services sector, the main driver of the TCe, posted a strong performance, although signs of slowdown emerged in 2024. Developments in tourism, transport, wholesale and retail trade, and higher education are key indicators of the overall performance of the services sector. Visitor arrivals by air and sea to the TC community (TCc) have trended upward, surpassing pre-pandemic levels. In 2023, arrivals hit nearly 1.9 million, a 31.1 percent yoy increase, continuing into 2024 with a slower 19.1 percent growth. Most tourists came from Türkiye, rising 22.5 percent in 2024, while visitors from other countries grew 3.7 percent, still below pre-pandemic figures. The overall growth can be attributed to the opening of a new airport in July 2023, which has expanded air transportation capacity.

Green Line (GL)[7] crossings—another key indicator of demand for services—sharply decelerated.[8] In 2024, total GL crossings increased by only 1.2 percent, reaching nearly 7.8 million, sharply slowing from the 17 percent growth in 2023. Unlike the trend observed between 2019 to 2023, Turkish Cypriots made up the largest share of crossings in 2024, at 38 percent, followed by Greek Cypriots at 36 percent and other visitors at 26 percent (Figure 1.3). However, the number of crossings by Greek Cypriots and other visitors declined by 7.4 and 7.2 percent in 2024, respectively, compared to 2023. In contrast, crossings by Turkish Cypriots rose by 19.1 percent, although below the 30.4 percent increase registered in 2023.

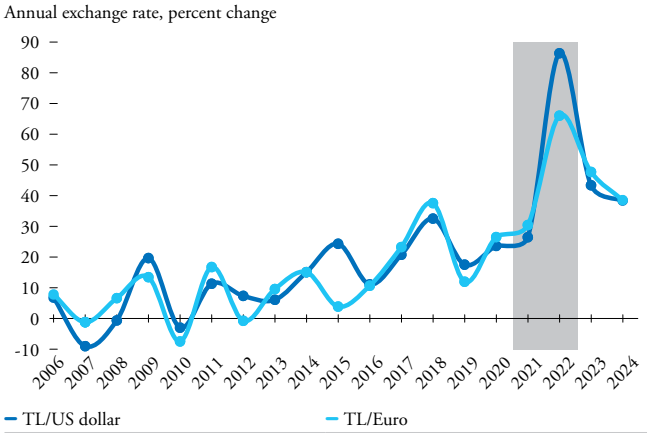
The decline in tourist arrivals and GL crossings largely stems from adverse economic developments in the TCe, notably persistently high inflation, and continued exchange rate volatility. Although consumer prices began to ease in May 2024, inflation remained high at 53.3 percent by December 2024. The volatility of the Turkish Lira against foreign currencies has also impacted GL crossings into the TCc (Figures 1.3 and

Figure 1.3 GL crossings by non-Turkish Cypriots fell…



Source: TCc 'statistics office'.
Note: TC=Turkish Cypriot; GC=Greek Cypriot; EUR/TL=Euro-to-Turkish Lira exchange rate.

Figure 1.4 …impacted by the volatility of the Turkish Lira against foreign currencies



Source: Central Bank of Türkiye.

7 The Green Line Regulation was adopted in April 2004. It sets out special rules for goods, services, and persons crossing the Green Line from the Turkish Cypriot community, which is outside the effective control of the government of the Republic of Cyprus and where the EU *acquis* is suspended, to the areas which are under the effective control of the government and where the *acquis* applies.

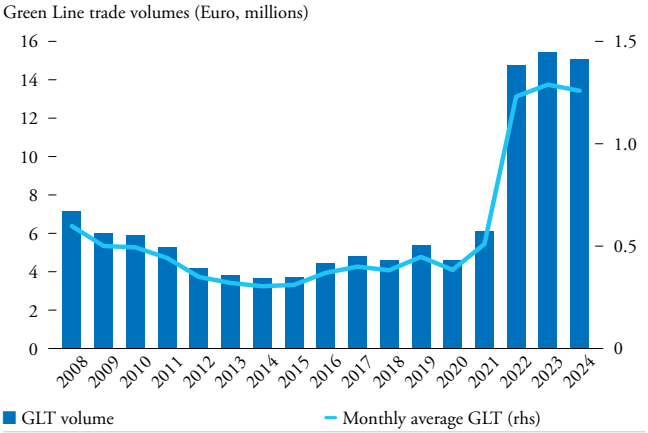
8 The slowdown in GL crossings points to a broader weakening in cross-communal economic engagement, particularly in the TCe's service sector. A drop in visits by Greek Cypriots and other non-resident consumers—traditionally vital to retail, hospitality, and tourism in the TCc—suggests falling external demand, likely due to persistent inflation in the TCe and widening price differentials. While more crossings by Turkish Cypriots may reflect increased reliance on lower-cost goods and services across the line, this is unlikely to fully offset the loss in visitor spending.

1.4). For example, the number of crossings by GCs increased by 52 percent in 2018 (y-o-y) and 46.1 percent in 2019, coinciding with the Lira depreciations of 38 and 12 percent against the Euro, respectively. A similar pattern was observed in 2022 and 2023, when the number of GC visitors rose by around 177 and 8 percent, respectively, in tandem with respective Lira depreciations of 66 and 48 percent.

The decline in GL crossings and the slower growth in arrivals have impacted the hospitality sector. Average occupancy rate of accommodation began to decline from May 2024, falling by 1.8 percent compared to 4.4 percent growth in 2023. The average length of stay also shortened: for visitors from Türkiye, it dropped slightly from 2.9 days in 2023 to 2.6 days in January 2025, while for other visitors, it fell more sharply from 4.7 to 3.8 days. This decline occurred despite a 3.8 percent capacity increase in 2024, measured by the number of available beds, following new facilities added in April 2024.

Following three consecutive years of growth, GL trade (GLT) volumes from TCc to GCc declined in 2024 (Figure 1.5).[9] In 2024, GLT volumes fell by 2 percent, totaling Euro 15.1 million. This marked a reversal from the 5 percent growth seen in 2023. The recovery that began in 2021, had continued into 2022 with a 141 percent surge in GLT as volumes rebounded from pandemic-related disruptions. However, this momentum did not carry into 2024, as volumes dropped slightly compared to 2023.

Figure 1.5 Green Line trade fell moderately in 2024



Source: TC Chamber of Commerce.

The developments in GLT are influenced by sectoral trends and regulatory changes. GLT continues to exhibit a high level of product concentration, with the top five products comprising 81 percent of total GLT. Although the product composition has remained relatively stable in recent years, there was a slight shift in the structure of the top 10 products in 2024. Prefabricated containers, which have consistently held the largest share of trade, accounted for 22 percent in 2024, down from 25 percent in 2023 (Table 1). This decline follows the implementation of regulations on

Table 1 Trade is concentrated in 5 products that account for over 80 percent of total GLT

Top 10 GLT products: shares and annual growth rates in 2024 and 2023

	Share in 2024	*Share in 2023*	*Growth in 2024*	*Growth in 2023*
Prefabricated container	22.0	25.0	-12.4	1.9
Wooden furniture	19.6	19.0	-1.6	2.4
Construction materials	14.8	24.0	-39.1	2.4
Plastic products	14.7	15.0	-1.1	26.0
Waste/scrap products	9.5	5.0	102.3	31.4
Fruit & vegetables	5.6	1.0	932.9	3375.9
Fresh fish	5.3	5.0	2.4	-3.4
Mattresses	4.0	4.0	-4.2	12.3
Paper and cardboard	1.1	1.0	-16.8	228.8
Potatoes	0.3	0.4	-39.3	238.6

Source: TC Chamber of Commerce, World Bank staff calculations.

9 Data on trade from the TCc to the GCc are provided by the Turkish Cypriot Chamber of Commerce. For trade in the opposite direction, the source is the Turkish Cypriot 'Department of Trade'.

construction materials by the RoC, in accordance with EU acquis. These regulatory changes contributed to a 12.4 percent decline in GLT for this product, amounting to a loss of nearly EUR 471,000 (3.1 percent of total GLT). Construction materials have also experienced a significant reduction in GLT volumes, falling by 39.1 percent yoy in 2024. Their share in total trade fell from 24 percent in 2023 to 14.8 percent in 2024.

GL trade declined as important product categories—prefabricated containers and construction materials—faced increased regulatory requirements, non-compliance, and adjustment. In response, producers in the TCe have begun exploring new markets to offset the loss of market share in the GCe, in parallel to ongoing efforts to upgrade product standards for compliance with EU requirements. However, these efforts have not yet fully compensated for the disruptions to GLT. On a positive note, trade in fruit and vegetables surged by nearly 933 percent, albeit from a low base, mainly due to the start of citrus trade in November 2023.

Despite strong 'export' growth, the trade deficit widened due to rising 'imports' from third countries. In 2023, total merchandise 'exports' (including sales to the GCe) grew by 27 percent nominally to US$159.5 million, but total merchandise 'imports' from third countries also rose 25 percent to US$2.8 billion, driven by domestic demand. As a result, the merchandise trade deficit increased by nearly 25 percent to US$2.7 billion. In contrast, net services trade recorded a surplus of US$ 2.4 billion, driven by sectors such as tourism, education, and financial services. This surplus helped reduce the overall trade deficit by 32 percent to US$236 million. While total trade data for 2024 are not announced by the TCc, mirror statistics from Türkiye's Statistics Institute (TUIK) suggest that TCc merchandise 'imports' rose about 10 percent yoy in nominal US$ terms, while 'exports' to Türkiye fell by 13.2 percent in 2024.

The geographical structure of trade has shifted significantly over the past five years, towards Türkiye. Trade ties of the TCc have expanded with countries in the north and east, while connections with north-western markets have diminished (Figures 1.6 and 1.7). For instance, Türkiye's share of total exports grew from 52.3 percent in 2019 to nearly 80 percent in 2023. By contrast, the EU's share fell from 5.3 percent to 1.7 percent, and the share of Middle Eastern countries more than halved. Similar trends are observed for 'imports'[10].

Figure 1.6 Türkiye's share of total 'exports' grew significantly, while connections with most other markets have declined…

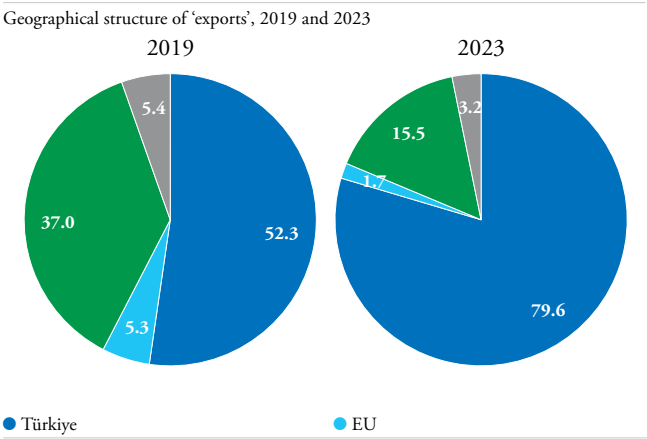
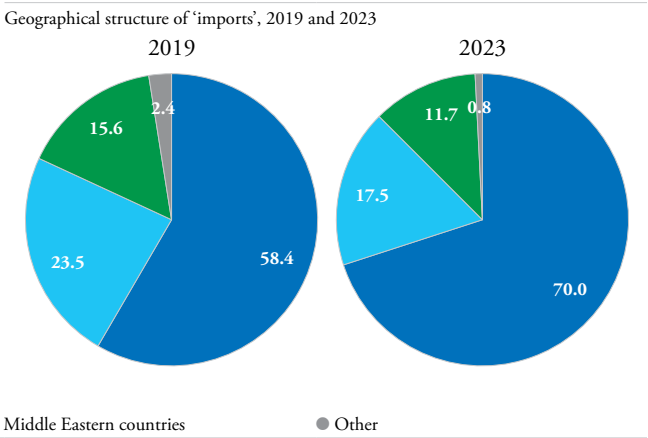


Figure 1.7 …with similar trends apparent for 'imports'



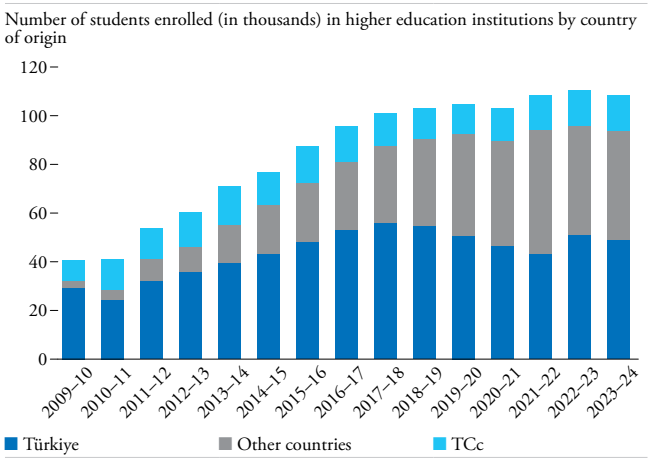
Source: TCc 'statistics office', 'central bank of TCc', World Bank staff.

10 Consequently, due to elevated price levels both in Türkiye and within TCe, the TL's real effective exchange rate appreciated significantly during 2022–2024 by about 23 percent. This appreciation made the sale of goods to third countries (outside Türkiye) more expensive.

Labor mobility between the TCe and GCe is key for economic integration

The higher education sector in the TC economy has grown substantially over the last decade, driven by the increasing enrollment of foreign students. The enrollment of foreign students has generally been on an upward trend since 2011, except for a 3 percent decline in 2020. The annual enrollment growth rate averaged 7.9 percent from 2011 to 2022. However, in the 2023–24 academic year, the enrollment of foreign students decreased by 2.3 percent, primarily due to a decline in students from Türkiye (Figure 1.8).

Figure 1.8 Foreign student enrollments in higher education declined in 2024



Source: TCc 'statistics office'.

Meanwhile, the number of students from the TCc has expanded only marginally, with their share in total enrollment falling from 30.7 percent in 2010–11 to just 13.5 percent in 2023–24 academic year. Factors contributing to the decline in enrollment include perceptions of lower educational quality, limited accommodation capacity, and restricted graduate employment opportunities.[11] In addition, the rapid rise in the cost of educational services, which surged by almost 113 percent in one year, is making the sector less appealing to foreign students. Recent reputational risks stemming from developments in the higher education sector also pose challenges to its future prospects.

The composition of the labor force shifted towards foreign workers in 2024. Foreign workers made up 51.9 percent of the total labor force in 2024, surpassing local employees, according to data from the TC Social Security Registry.[12] This shift reflects both expanding employment opportunities and the impact of the TCc's initiative to subsidize social security premiums through the Local Workforce Development Fund. By reallocating payroll contributions into targeted premium-support payments, the scheme helped businesses manage labor costs more efficiently throughout the year. However, the sustainability of this model has faced mounting challenges. A slowdown in the construction sector led to a decline in demand for new work permits, thereby reducing the subsidy base. Simultaneously, recent human rights allegations concerning the recruitment of foreign workers have increased compliance risks for both the local bodies in the TCc and private employers. In response to these pressures, the social security premium-support scheme was discontinued in February 2025.

Although limited, intra-island labor mobility holds strategic value for economic integration. In 2023, only 3,153 of the 76,550 employed TCs in the TCe (about 4.1 percent) worked in the GCe.[13] While this cross-communal workforce remains small, it serves as a meaningful conduit for economic integration and knowledge spillovers, enabled by the GLR's services provisions. To fully leverage these benefits and guide effective policy, future empirical research should evaluate the impact of this labor mobility on wages, productivity, and skills transfer across the divide.

1.2 High inflation persists due to external factors, local policies and structural rigidities

The TCc relies on the Turkish Lira and lacks independent monetary policy tools, making it vulnerable to decisions by the Central Bank of Türkiye (CBRT). In response to persistent inflationary pressures driven by the sharp depreciation of the Turkish

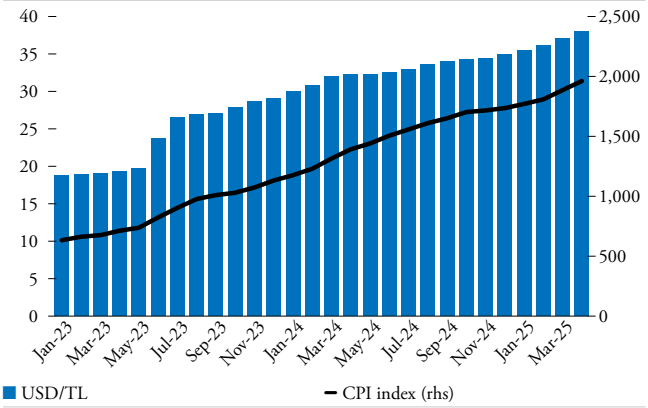
11 World Bank (2022).

12 TCc 'central bank' (Bulletin 2024-Q4).

13 Social Security Statistics of the GCe.

Lira, the CBRT launched a monetary tightening cycle in June 2023, initially setting the policy rate at 15 percent. Subsequently, the CBRT implemented a series of aggressive rate hikes, raising the policy rate to 45 percent in January 2024 and further to a peak of 50 percent in March 2024. This restrictive monetary stance was maintained until November 2024, after which rates began to ease, gradually declining to 42.5 percent by March 2025 and then raised to 46 percent in April 2025.

Figure 1.9 The link between the USD/TL exchange rate and Consumer Price Index is robust

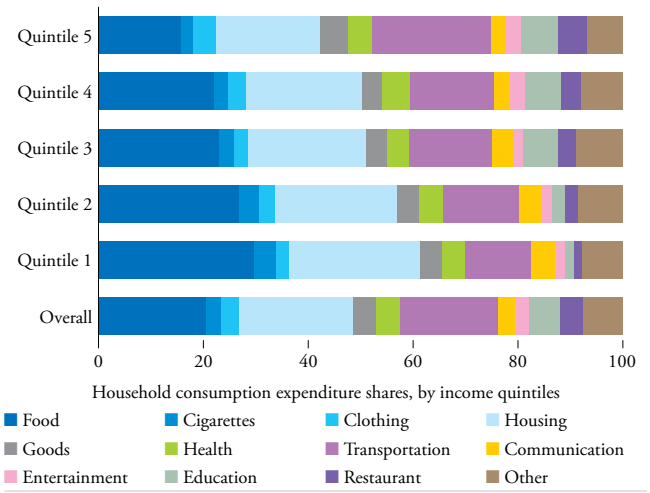


Source: TCc 'statistics office', CB of Türkiye.
Note: USD/TL=US$ to Turkish Lira exchange rate; CPI=Consumer Price Index.

Given the high exchange rate pass-through, CBRT's aggressive monetary policy stance helped stabilize the exchange rate, and contain further price escalations. As a result, the TC economy, which also uses the Turkish Lira, saw a decline in inflation, falling from 83.63 percent in December 2023 to 53.29 percent by the end of 2024—still elevated. The strong influence of currency movements is evidenced by a robust relationship between the USD/TL exchange rate and the Consumer Price Index (CPI) (Figure 1.9).[14] Despite this overall moderation, inflation remained stubbornly high in certain key sectors, pointing to structural rigidities and sector-specific challenges. Notably, inflation in education, while easing, remains elevated at 99.32 percent in 2024 compared to 116.63 percent in 2023. Clothing and footwear saw inflation rise from 70.66 percent in 2023 to 76.79 percent in 2024, while miscellaneous goods and services witnessed a slight increase—from 80.70 percent in 2023 to 81.36 percent in 2024.

However, the exchange rate alone does not fully account for high inflation. In 2024, the TL depreciated by around 18.73 percent against the US$, rising from 29.77 TL to 35.34 TL per US$. Yet, during the same period, consumer prices surged by 53.3 percent, indicating that prices outpaced the currency's depreciation against the Euro. This disparity points to additional inflationary drivers other than exchange rate movements. Key contributing factors include rising costs of goods and services, increased production expenses—particularly due to a growing wage bill—persistent inflation expectations and surging aggregate demand. The latter was associated with a significant expansion in the foreign labor force (discussed above).

Figure 1.10 Essential goods make up a large share of low-income household expenditures



Source: Household Budget Survey 2022, TCc 'statistics office'.
Note: Quintile 1 represents the lowest income of the 5 quintiles.

Inflation continues to put disproportionate pressure on poor and vulnerable households. First, these households have very limited income to absorb higher prices and are more exposed to inflationary shocks because they spend a larger proportion of their income on essential goods and services. In the TCc, low-income households devote a significant portion of their

14 Regression analysis reveals an exchange rate pass-through (ERPT) elasticity of 1.53, meaning a 1 percent depreciation in the exchange rate leads to a 1.53 percent increase in CPI. An ERPT elasticity greater than one suggests a strong and disproportionate impact of currency depreciation on domestic prices, emphasizing the importance of exchange rate stability in controlling inflation.

budgets to four critical expenditure categories: food and non-alcoholic beverages (29.7 percent), housing, water, electricity, gas, and fuel (25.0 percent), and transportation (12.5 percent) (Figure 1.10). Elevated prices in these essential categories threaten their well-being, reduce real incomes and exacerbate socioeconomic vulnerabilities.[15]

1.3 Fiscal pressures remained elevated

The fiscal deficit increased from 0.9 percent of GDP in 2023 to 4.1 percent in 2024, as revenues increased at a slower pace than expenditures. Domestic revenues, excluding grants, increased from TL 33 billion in 2023 (about Euro 1.3 billion or 25 percent of GDP) to TL 64 billion (about Euro 1.8 billion or 26.3 percent) in 2024 (Figure 1.12). This revenue growth was primarily driven by higher income tax collections linked to rising public sector wages, as well as increased tax revenue from foreign trade. Within the overall revenue structure, the share of indirect taxes increased from 22.9 percent to 25.5 percent of total revenues, while direct taxes decreased from 40.6 percent to 37.4 percent. A notable development was the substantial rise in external grants, which increased from 3.2 percent of GDP in 2023 to 5 percent in 2024, the highest level since 2015 (Figure 1.14). Investment grants nearly quadrupled to 2.6 percent of GDP, the highest in the past decade. Despite the increase in grants, the fiscal deficit widened considerably—from 0.9 percent of GDP in 2023 to an estimated 4.1 percent in 2024—as expenditure growth outpaced revenue growth (Figure 1.13). The fiscal deficit was financed through a combination of TCc 'central bank' profits, domestic debt issuance, and short-term advances from the TCc 'central bank'.

Following several years of fiscal consolidation, 'public' expenditures have risen significantly, approaching pre-pandemic levels. In nominal terms, total expenditures more than doubled, surpassing TL 85 billion (equivalent to EUR 2.6 billion) in 2024 vs. 2023. As a result, their share of GDP increased from 29.2 percent in 2023 to 35.4 percent in 2024. This surge was mainly driven by growth in current transfers, wages and compensation expenditures (as the public sector wage was adjusted for inflation several times in 2024), followed by significant increases in other current and capital expenditures (Figure 1.11, Box 1). Although transfers remained the largest expenditure category, their share of total spending fell from 44.3 percent in 2023 to approximately 41 percent in 2024. Similarly,

Figure 1.11 Rising 'public' expenditures are driven by wages and transfers

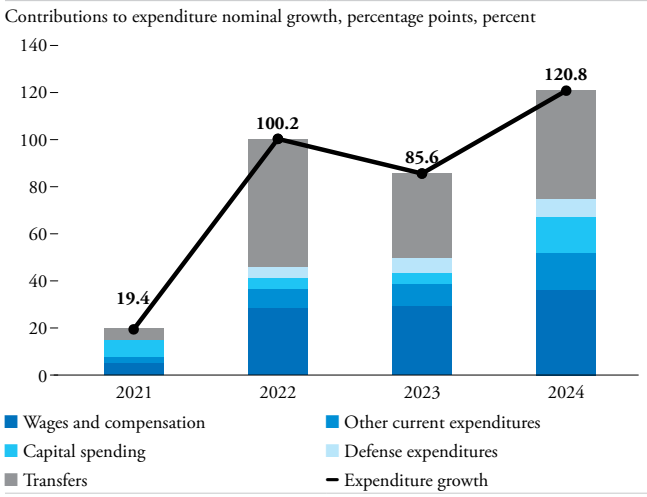
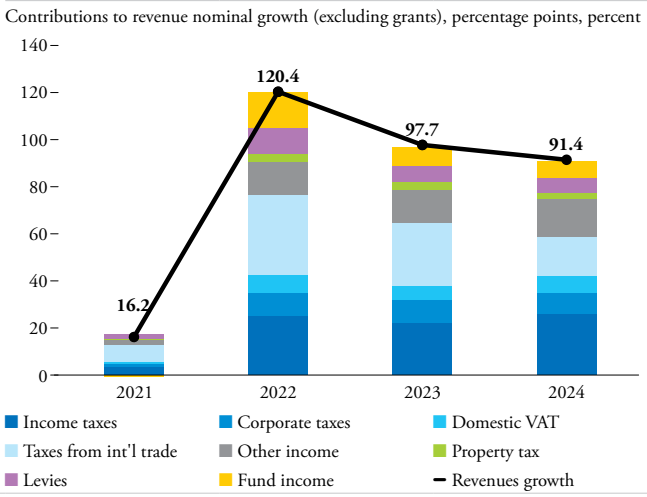


Figure 1.12 Fiscal revenues have grown more slowly than expenditures



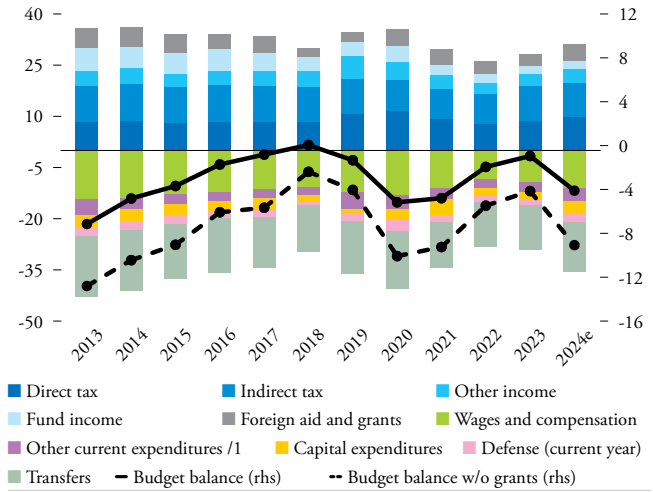
Source: World Bank staff calculations based on data from TCc local body responsible for finance.
Note: Total minus wages and compensation, capital expenditures, defense and transfers.

15 More detailed analysis on poverty in TCe could be found here "Estimation of an Absolute Poverty Line for the TCe". World Bank 2024. https://www.abbilgi.eu/publications/estimation-absolute-poverty-line-turkish-cypriot-economy-2202.

expenditure on wages and compensation decreased from 32.1 percent of total spending to 30.9 percent in 2024. In contrast, the share of capital spending increased from 7 percent in 2023 to 10.2 percent in 2024, presumably due to higher spending on repairing/reinforcing school facilities and constructing new administrative buildings (including with the financial support from Türkiye).

Figure 1.13 The fiscal deficit increased significantly

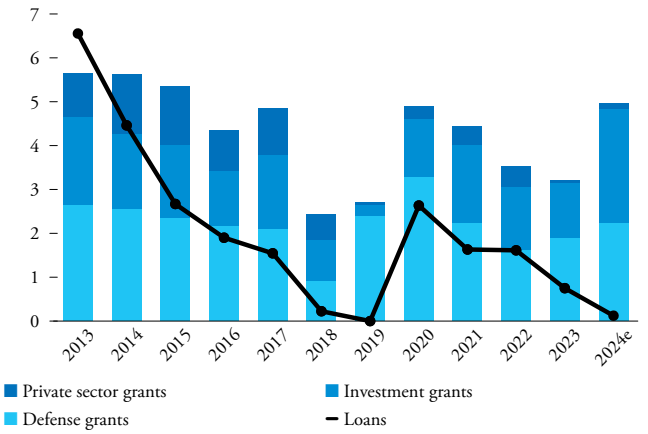
Structure of revenues and expenditures, and the fiscal deficit, percent of GDP



Source: World Bank staff calculations based on local body responsible for finance in the TCc.
Note: /1 Residual category. Total minus wages and compensation, capital expenditures, defense and transfers.

Figure 1.14 There has been a substantial rise in grants, especially investment grants

External financing sources, 2013–2024e, percent of GDP



Source: TCc local body responsible for finance.

Box 1 Wage adjustments in the TC economy have been responding to high inflation

Between 2023 and 2025, wage-setting dynamics in the TCc have been defined by a reactive effort to counter persistently high inflation, further intensified by the depreciation of the Turkish Lira. Annual inflation stood at 94.5 percent in 2022, eased to 83.6 percent in 2023, and declined to 53.3 percent in 2024. These elevated inflation rates have placed considerable strain on household finances, with wages frequently failing to keep pace with rising prices.

In the 'public' sector, wages are effectively indexed to inflation, as civil service regulations required salary adjustments aligned with inflation rates. For example, the minimum civil service salary rose from TL 34,430 in May 2024 to TL 56,079 in January 2025, an increase of 63 percent. While these automatic adjustments help to safeguard the purchasing power of civil servants, they also impose significant fiscal burdens. Monthly spending on salaries and pensions totaled TL 2.36 billion—almost 80 percent of the budget or 20 percent of GDP annually, substantially higher than the GCe's corresponding figure of around 14 percent of GDP (compared to about 13.4 percent of GDP in Türkiye[16] and about 8.1 percent of GDP in the average EU country[17]).

16 Eurostat. Includes expenditures on wages and salaries and social security benefits in 2023.
17 Eurostat. Includes average expenditures on wages and salaries for 24 EU countries in 2022.

Box 1 continued

The statutory minimum wage, set by the tripartite '*Minimum Wage Determination Commission*', has become a crucial policy tool to mitigate income erosion. While previously revised once or twice a year, reviews increased to every four months from late 2023, enabling quicker adjustments to inflation. Between January 2023 and January 2025, gross minimum wage increased by approximately 243 percent, from 13,563 TL to 46,469 TL.

In the private sector, collective bargaining is weak, with most employers sticking to the minimum wage and with few workplace and non-sectoral agreements in place. This contrasts with the RoC GCA and other EU economies, where collective agreements, including cost-of-living adjustments (COLA), are common. RoC has partially reinstated COLA, granting workers 50–66 percent of annual inflation, better protecting real incomes than the TCc's *ad hoc* increases.

The informal labor market further complicates wage-setting, with many foreign students and undocumented migrants working unregistered in sectors like hospitality, agriculture, domestic work, and construction—often earning below the minimum wage. Despite occasional amnesties and inspections, limited enforcement has allowed informality to persist, suppressing wages and shrinking the tax base amid rising public spending.

1.4 The TC banking system remains resilient, although risks stem from sectoral performance

Gross banking sector loans grew strongly by 41.2 percent in 2024, however an increasing FX loan to deposit rate raises risks. This acceleration was primarily fueled by an increase in working capital loans for corporations and consumer loans for households. In comparison to 2023, loans denominated in the local currency grew by 25.2 percent, whereas loans in foreign currencies expanded by 50.1 percent. The heightened production costs faced by businesses led to a greater demand for working capital, while the robust labor market and improved consumer confidence stimulated the demand for consumer loans. In 2024, total deposits increased by 32.7 percent, while the proportion of deposits in foreign currencies decreased by nearly 10 percentage points to 74.3 percent, and the share of loans in foreign currencies rose to 68.2 percent (Figure 1.15). If this trend persists, it could heighten the risks associated with currency mismatches and potentially expose the banking system to indirect systemic vulnerabilities.

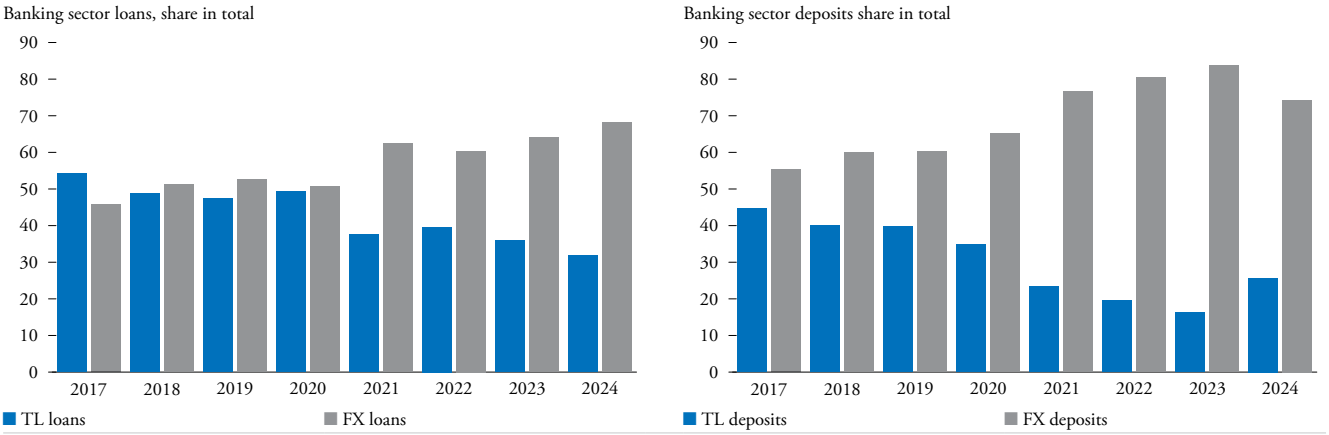
The quality of banks' loan portfolios showed a modest improvement, with the share of non-performing loans (NPLs) falling from 4.6 percent at the end of 2023 to 3.8 percent by the end of 2024. In addition, the provisions for NPLs (as a percentage of total NPLs), increased from 47.2 percent to 56.2 percent by the end of 2024, indicating enhanced coverage. However, provisions for foreign exchange loans experienced a slight decline, dropping from 89.3 percent to 75.8 percent by the end of 2024. Given these developments, it is crucial to closely monitor and address risks emerging from the financial sector.

Regarding the sectoral distribution of loans, gross consumer loans and credit card debt comprised the largest share at the end of 2024, jointly accounting for about 22 percent. This was followed by the construction sector at 16.3 percent, and wholesale and retail trade at 14.2 percent. Notably, the construction sector holds a significant share of NPLs, which reached 20.1 percent of the total NPL volume by the end of 2024—a substantial increase from 11.1 percent at end-2023. The construction sector showed signs of slowing down in 2024. If this trend continues and the sector's performance further deteriorates, it could lead to an increased share of NPLs in this sector and a decline in asset quality within the banking sector.

The banking system's levels of stability, capitalization, and profitability remained strong (Figure 1.16). The overall capital adequacy ratio (CAR) rose by 2 percentage points, reaching almost 20 percent at the end of 2024. The CAR improved across all banking groups, including private banks, where it is lowest at 13.2 percent but still exceeds the legal limit. This improvement appears to be driven by a higher increase in assets carrying low risk. Following a strong performance in 2023, profitability increased further during 2024, along with key return indicators. Return on average assets (ROAA) rose from 4.1 percent at the end of 2023 to 6.6 percent in 2024, while return on average equity (ROAE) increased from 57.4 to 69.9 percent in 2024.

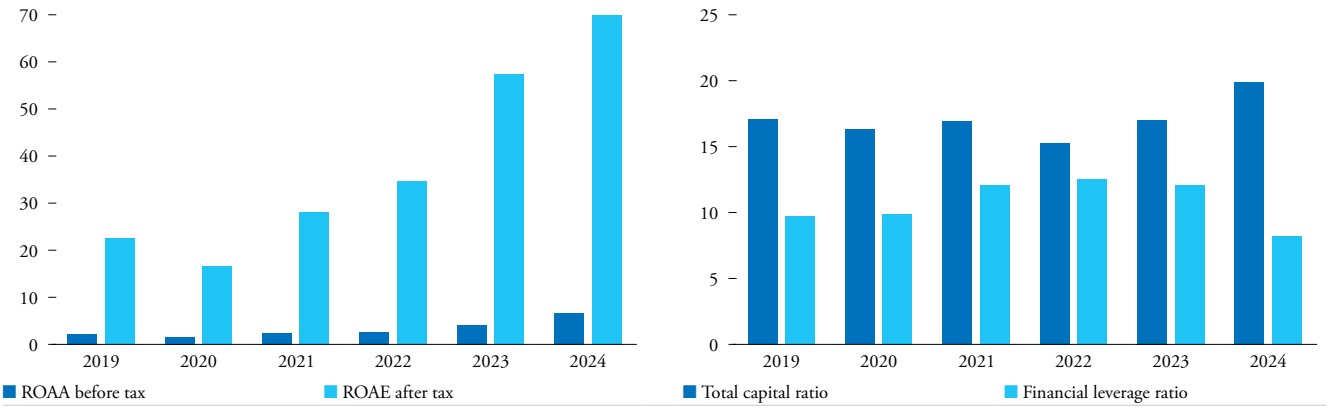
Risks persist due to economic uncertainties impacting the services and construction sectors. Trade uncertainties and 'export' market volatility could hurt corporate performance, particularly in tourism. A slowdown in construction, lower investment, and rising reputational risks could strain company balance sheets, raise non-performing loans, and weaken banks' financial health. Financial supervisors must proactively monitor these risks and ensure banks can manage potential asset quality declines. Banks should uphold strong credit risk management practices, including accurate loan classification, staging, and provisioning. Regulators must remain alert, particularly regarding construction and real estate lending, unsecured consumer credit, highly leveraged borrowers, and inflation-sensitive sectors.

Figure 1.15 Increasing FX loans and decreasing FX deposits raise risks for the banking system



Source: TCc 'central bank'.

Figure 1.16 Banking sector profitability and capitalization remain strong



Source: TCc 'central bank'.
Note: ROAA=Return on average assets; ROAE=Return on average equity.

1.5 The outlook for 2025 has weakened subject to global trade uncertainty and downside risks

Growth projections for the euro area in 2025 have been revised down from 1.3 percent to 0.9 percent, weighed down by rising global trade barriers, policy uncertainty, and subdued consumer and business confidence. In Germany, worsening business conditions, especially in manufacturing, may further reduce exports from many ECA countries tied to European supply chains.

In the GCe, growth is expected to remain strong, but to slow to 3.0 percent in 2025 from 3.4 percent in 2024, supported by Recovery and Resilience Facility investments and easing financial conditions. Exports should benefit from rising tourist receipts, and a robust services sector, particularly ICT. Household purchasing power is projected to increase due to higher nominal wages and lower inflation, boosting private consumption.[18]

Türkiye's economic growth is projected to remain stable at 3.1 percent in 2025, driven by strong consumption, wage gains, and labor market performance. Inflation is expected to ease, with tight monetary and fiscal policies targeting 5 percent. However, downside risks persist due to policy uncertainty, delayed fiscal consolidation, and slow structural reforms. Continued TL real appreciation, while essential for disinflation, could weigh on external demand. The delay in fiscal consolidation—particularly on the expenditure side—and slow progress on structural reforms could further stall disinflation. Externally, lower commodity prices, notably oil prices, greater global economic uncertainty, and possible adverse trade policy shifts pose negative risks to this growth outlook.[19]

Considering regional dynamics and global trade challenges, growth of the TCe is expected to moderate to 4.2 percent in 2025, reflecting weaker external and domestic demand, persistent inflation, and fiscal pressures. On the demand side, consumption is projected to be the key driver of growth, supported by cost-of-living adjustments, while investment is set to decline due to reduced construction, owing to limited domestic revenue and lower external financing from Türkiye. Expected fiscal tightening in Türkiye may further constrain the TCc local budget and spending. Higher borrowing costs from monetary tightening may also dampen investment. Net 'exports' are projected to weigh on growth amid weaker demand from key partners like Türkiye and the EU, alongside global trade uncertainty and shifting tariffs. However, lower global demand and declining oil prices could ease energy costs and slow import growth. On the supply side, services, particularly tourism, will support growth, while construction is expected to act as a drag due to slowing activity, weak real estate demand, and ongoing reputational issues.

In times of uncertainty, addressing structural challenges is key for promoting sustained, inclusive growth. With high inflation and no independent monetary policy lever, fiscal policy must focus on controlling spending growth, improving spending quality, and increasing domestic revenue by broadening the tax base, eliminating regressive exemptions, and strengthening tax policy and tax administration. The TCc local bodies must first understand how fiscal policy impacts inflation and households, including its distributional effects. It also needs to assess existing public wage-setting mechanisms that adjust solely for inflation increases but remain unchanged when inflation rates fall, as well as their ripple effects on private sector salaries. Rising social protection demands, driven by declining purchasing power, have strained the budget. Better targeting is needed—refining eligibility for the "Poor in Need" program[20] and shifting subsidies toward well-targeted cash transfers supporting vulnerable groups. With limited fiscal space, the TCc 'administration' should prioritize high-impact investments in education, R&D, and infrastructure, while phasing out untargeted,

18 EC. Spring 2025 Economic Forecast. https://economy-finance.ec.europa.eu/economic-forecast-and-surveys/economic-forecasts/spring-2025-economic-forecast-moderate-growth-amid-global-economic-uncertainty_en.

19 World Bank. 2025b.

20 Currently, the "Poor in Need" program has an age limit and de facto, the TCc does not have a program to support poor people just because they are poor.

distortionary subsidies—especially in agriculture, where funds mostly support direct income transfers over productivity.[21] A comprehensive review of tax policy, expenditures, and public spending is essential to enhance fiscal efficiency. Finally, strengthening institutional capacity through improved inter-agency coordination, enhanced data infrastructure, and performance-based budgeting is key to successful reforms and sustainable growth.

21 World Bank. 2021.

Part II Special Issue: Unlocking Trade Potential

This Special Issue explores opportunities for economic integration, focusing on some of binding constraints, including restrictions to trade. It highlights that regulatory restrictions to trade (also known as "non-tariff measures"), such as licenses and pre-permits, significantly drive up prices of goods entering the TCc market. By analyzing product-level trade data, this special issue illustrates how these barriers hinder market access, increase costs for businesses and consumers, and limit 'export' performance. These restrictions, in turn, weaken the competitiveness of the TCe and hamper trade integration with the GCe—with the EU single market and the rest of the world. The study recommends eliminating 'licenses and pre-permits, simplifying processes, adopting risk-based compliance, implementing efficient market surveillance and enhancing transparency through a central portal. To improve trade, targeted investments in productive capacity, logistics, standards, quality infrastructure, and access to market information are essential. Reforms to improve the business environment would also play a critical role in improving the competitiveness of locally produced products.

2.1 There is unrealized trade potential

In 2024, Green Line trade from the TCe to the GCe reached US$17 million—nearly 14 times the trade value from the GCe to the TCe—highlighting the ongoing trade imbalance. In fact, although trade from the GCe to the TCe falls outside the scope of the GL Regulation, it has remained modest, averaging around $1.2 million annually between 2011 and 2023.

A set of local restrictions significantly hampers the amount and type of trade. Local trade barriers relating to logistics, payments, taxation, phytosanitary standards, and entry restrictions severely constrain the movement of goods between the GCe and the TCe (COM, 2021).[22] Both the GCe and TCe apply restrictions on several products. For instance, the RoC does not authorize the crossing of all processed food products of non-animal origin due to food safety concerns. Although some exemptions have been put in place between the parties in the last two years, these are not yet reflected in increased trade figures. The TCe also applies similar restrictions on goods crossing to the TCe from the GCe. Moreover, goods can only be traded from the GCe to the TCe once a license or permit has been issued by TC local bodies. This regime, however, is not always consistently applied. For these reasons, current GLT (and related data), both in terms of its volume and composition, represents only a small fraction of the productive capabilities and trade possibilities between the GC and TC economies.

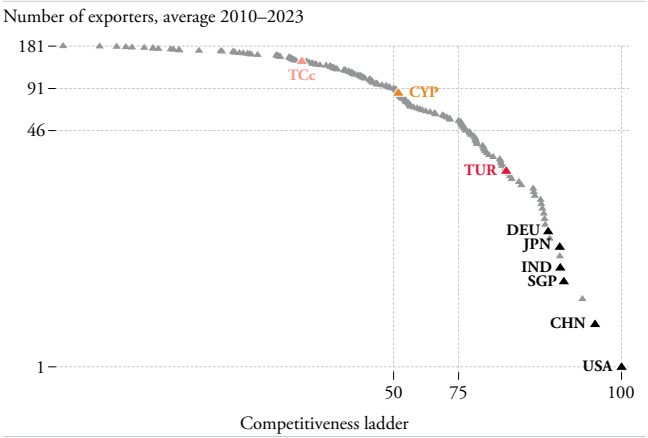
Increased trade and economic integration drives economic development. With increased economic integration, it is possible to expand intra-island trade and introduce new products. Moreover, while both the TCe and the GCe could ultimately benefit from increased economic integration, the TCe has significant opportunities to catch up economically with the productive capabilities and knowledge-intensiveness of the GCe. Economic integration would contribute to creating new jobs and generating technology spillovers, which are critically important for addressing the current challenges of trade fragmentation and climate change.

22 These considerations relate to formal commercial exchanges of products across the two communities and do not capture personal consumption/spending across the Green Line, which is not recorded and the threshold is EUR 260.

2.2 Trade is inhibited by bilateral frictions[23]

This section assesses the relative performance of TC traders and the extent of unrealized trade potential. The analysis aims to estimate the potential trade volume between the TCe and the GCe under conditions similar to those prevailing in neighboring economies, while also benchmarking the competitiveness of TC 'exports' against regional and global peers. A structural gravity approach is used to analyze bilateral trade flows, based on economic fundamentals and observed trade patterns (for details see the Annex). The resulting revealed competitiveness index is used to assess the TCe's position in global markets.

Figure 2.1 The TC economy is one of the lowest when it comes to export competitiveness



Source: World Bank staff calculation based on BACI dataset plus data from TCc 'department of customs'.
Note: The graph reports the normalized exporter multilateral resistance term estimated with a structural gravity equation: estimation is conducted for the period 2010–2023. See Annex for methodological details.

The persistent underperformance of the TC economy in 'export' competitiveness from 2010 to 2023 highlights deep-rooted structural challenges. Figure 2.1 presents normalized exporter fixed effects as a summary measure of export performance across economies, adjusted for differences in product mix and market access. The TC economy consistently ranks among the lowest performers, well below both the RoC (positioned in the middle tier) and Türkiye, which ranks significantly higher. These findings suggest that, beyond regulatory and institutional barriers, the TCe faces difficulties related to firm-level capabilities, limited scale, and weak integration into global value chains. These deficiencies are linked to lack of integration with the GCe and the EU, as investment and technology spillovers are hindered by the existing divide between the two communities.

The GL Regulation enables trade between the TCe and the GCe, but unrealized GL trade remains substantial. To quantify this unrealized trade along the GL, a theoretically consistent gravity model[24] is used to simulate counterfactual trade flows between the two economies, assuming they face the same bilateral frictions as comparable neighboring pairs (Box A1).[25] The analysis isolates the portion of unrealized trade specifically attributable to bilateral frictions rather than broader differences in global market access or competitiveness. The findings reveal a persistent gap between actual and potential trade flows across the GL (Figure 2.2). This 'missing trade' indicates untapped potential that could be realized by reducing bilateral frictions. These estimates provide a quantitative benchmark for assessing the economic cost of market

23 Recent evidence shows that border effects persist even within highly integrated regions like the European Union. Santamaría *et al.* (2023) find that intra-EU trade remains well below levels expected in a frictionless environment, due to bilateral frictions such as regulatory complexity, administrative barriers, and localized trust. The gap between predicted and actual trade across the Green Line, therefore, reflects not a lack of EU support but the continued presence of micro-level and institutional barriers. Addressing these requires targeted confidence-building and greater regulatory convergence, aligned with broader EU integration goals.

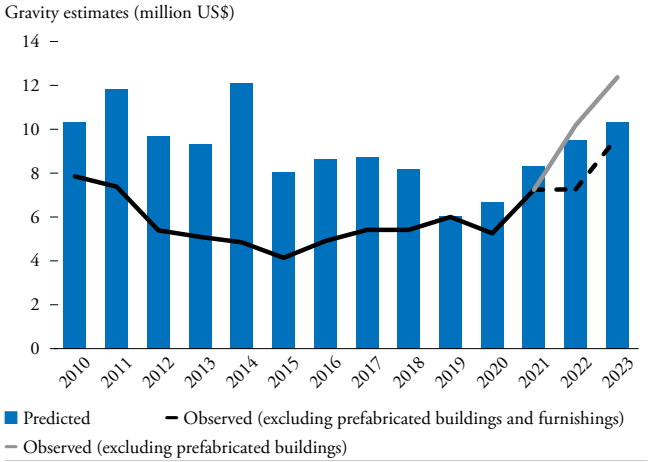
24 A gravity model explains international trade using an analogy with Newton's law: larger economies trade more, while trade declines with distance and other barriers. Modern versions also consider multilateral resistance—the ease of trading with the rest of the world. This report uses a structural gravity model to simulate the TC economy's potential exports to the GCe under varying trade frictions. The gap between actual and predicted exports—known as missing trade—reflects unrealized potential due to regulatory or institutional barriers (see Anderson, 2024).

25 This builds on Gokcekus et al. (2012), who identify both formal barriers (e.g., import licensing, customs procedures) and informal constraints (e.g., lack of mutual recognition of standards, limited institutional trust) as key impediments to Green Line trade. Recent evidence indicates that border effects persist, even in highly integrated regions such as the European Union. Santamaría, Ventura, and Yeşilbayraktar (2023) demonstrate that intra-EU trade is substantially lower than it would be in a frictionless environment. They point to the role of bilateral frictions, such as regulatory complexity, administrative barriers, and localized trust, in shaping trade patterns. Thus, the discrepancy between predicted and actual trade across the Green Line does not necessarily indicate a lack of EU support; rather, it highlights the ongoing presence of micro-level and institutional barriers that hinder trade integration. Addressing these challenges requires targeted confidence-building measures and greater regulatory convergence on both sides, in line with broader EU integration goals.

fragmentation and strengthen the case for policies that promote deeper trade integration on the island.[26]

Overall, the findings underscore the persistent impact of current regulatory limitations, while also highlighting the potential for greater convergence. This analysis quantifies the impact of current limitations in the number of tradable products across the Green Line. However, sustained increase in GL trade will likely depend on complementary investments in productive capacity, logistics, standards, quality infrastructure, and improved access to market information and access to finance opportunities. The TCe, for example, could potentially supply both the GCe and broader EU markets with products currently imported from elsewhere, including both processed and unprocessed food.

Figure 2.2 TC trade across the GL is below potential

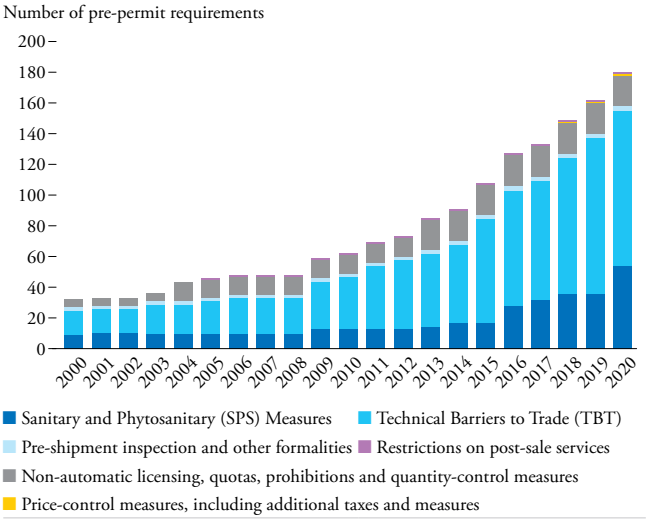


Source: Turkish Cypriot Chamber of Commerce.
Note: This figure presents the simulated value of sales from the TCe to the GCe based on the structural gravity model (Box A1). The graph highlights the gap between actual ('Predicted'). The increase in actual 'exports' in 2022–2023 was driven by a limited number of product categories, including prefabricated buildings, wooden dining and living room furniture, marble flooring and wooden bedroom furniture. 'imports' of furnished prefabricated buildings in RoC are now subject to additional requirements and are excluded from the observed 'export' values shown in this figure. Instead, the comparison focuses on structurally persistent trade flows to better assess the underlying 'export' potential relative to model predictions and counterfactual. Data for 2024 are available for GL trade, but are not available for all other countries (these are necessary to estimate the gravity model also for 2024).

Regulatory restrictions are stifling trade and growth

Trade can have a sizable impact on both consumer welfare and firms' competitiveness. On the demand side, access to international goods allows consumers to enjoy greater variety in their consumption baskets, while the increased availability of foreign products can lower prices and enhance purchasing power. Available evidence indicates that protectionist policies not only increase prices for consumers, but also reduce competitiveness, limiting access to parts and components for local manufacturing. In fact, on the supply side, access to foreign inputs enables firms to lower production costs and improve competitiveness. Such participation in global production networks can boost firm performance (Chaney, 2014).

Figure 2.3 The number of pre-permit requirements for goods entering the TCe is increasing



Source: World Bank staff calculations based on data from local bodies in the TCc issuing pre-permits.

Most goods entering the TC market are subject to pre-permit requirements. Unlike in the EU, where compliance is typically checked at the border or at the market, the TC requires pre-permits for technical reasons—such as protecting human, animal, and plant health; safeguarding the environment; and

26 In 2022 and 2023, TC exports to the GCe rose sharply due to prefabricated buildings and furnishings, temporarily exceeding gravity model predictions. With new restrictions on these products, core trade now aligns with or slightly surpasses expectations under the Green Line framework, though remains below direct trade potential. This indicates progress in overcoming barriers, but a large export gap remains. Closing it will require easing structural barriers, improving certification access, and strengthening firms' export capacity.

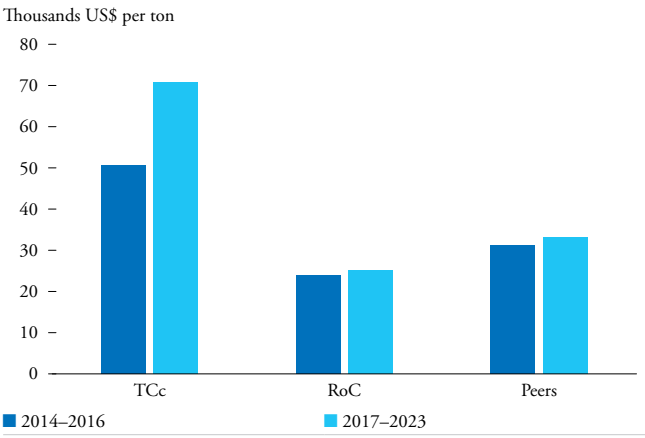
ensuring compliance with industrial standards. Pre-permits are used as a means to evaluate the risk of the commodity prior to its importation and to communicate requirements to the importer, but the efficiency and effectiveness of pre-permits is questionable, as most of them appear to offer only a partial and superficial assurance that their declared objectives are achieved. In addition to these technical permits, and despite some reforms already introduced by the TCc 'administration', licenses are issued for several goods entering the TC market, regardless of technical considerations, with protectionist intentions. As shown in Figure 2.3, the number of technical requirements (pre-permits) increased from 64 in 2010 to 180 in 2020. To ensure that these measures serve their intended policy objectives without unnecessarily restricting market access, each one should be evaluated individually.

To assess the determinants of price differentials in the TCe, this section examines two key dimensions: the average price of goods accessing the TCe—proxied by unit values—and the number of source economies per product, referred to as "varieties." Figure 2.4 presents comparative data on average import prices (measured in thousand US dollars per ton) and Figure 2.5 shows sourcing diversity (number of varieties per HS6 product) for the TCe, the RoC, and a group of peer economies.

The TCe pays considerably higher prices for the same 'imported' goods than similar economies. Between 2014 and 2023, the TCe paid an average of US$59.1 thousand per ton of imported products, compared to US$24.4 for the GCe and US$32.1 for the peer group—about 2.4 times more than the GCe and 1.84 times more than peer economies.[27] In terms of sourcing diversity, the TCe also appears significantly constrained (Figure 2.5), with the number of varieties per product roughly 4.7 times lower than the peer average (1,282 versus 5,973), suggesting limited access to competitive international supply markets.

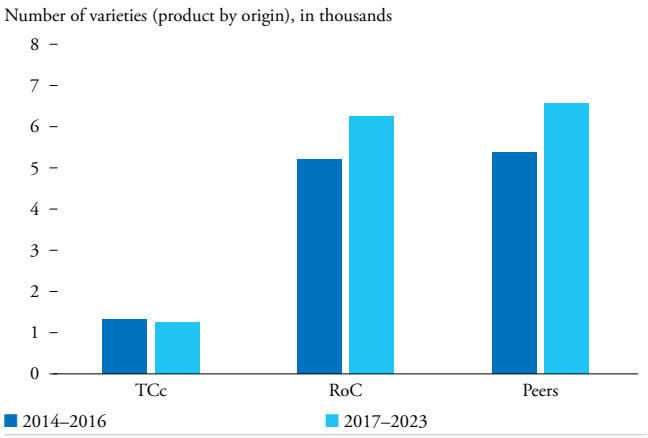
The high 'import' prices in the TCe may result from a composition effect, where limited sourcing from higher-priced suppliers inflates average prices. If an

Figure 2.4 'Import' prices are higher for the TC economy than for peers



Source: World Bank staff calculation based on BACI dataset plus data from TCc 'department of customs'.
Note: Prices are computed as trade-weighted average unit values (US$ per 1,000 kg) at the HS6 product level. Number of varieties is defined as the number of unique product-origin combinations. Sample limited to HS6 products imported by TCc. Benchmark countries include the Republic of Cyprus, Greece, Malta, and Slovenia.

Figure 2.5 Sourcing diversity is also less than for peers



Source: World Bank staff calculation based on BACI dataset plus data from TCc 'department of customs'.
Note: Prices are computed as trade-weighted average unit values (US$ per 1,000 kg) at the HS6 product level. Number of varieties is defined as the number of unique product-origin combinations. Sample limited to HS6 products imported by TCc. Benchmark countries include the Republic of Cyprus, Greece, Malta, and Slovenia.

27 The average price differences reported in Figure 2.5 are useful for descriptive purposes but should not be interpreted directly as evidence of regulatory effects. These figures may be affected by differences in product mix, supplier characteristics or unit quality between countries. To isolate the part of the price wedge attributable to regulatory frictions, the analysis relies instead on a gravity-based econometric model with product-origin-year fixed effects. This approach limits the comparison to a group of similar destination countries and controls for destination-specific characteristics-such as GDP, population, and inflation-at the year level.

economy primarily 'imports' more expensive, higher-quality varieties, these higher costs could reflect quality differences. Evidence shows that lower input tariffs lead firms to import more expensive intermediate goods, particularly from advanced economies, which improve 'export' product quality (Bas and Strauss-Kahn, 2015). Similarly, Manova and Yu (2017) find that firms in advanced economies specialize in higher-quality goods, indicating that broader or cheaper access to foreign suppliers encourages firms to shift toward better inputs, affecting 'export' competitiveness.

To determine whether higher 'import' prices in the TCe are caused by factors like product mix or regulatory and market frictions, a gravity-type regression model is estimated (Box A2).[28] This model helps separate out the portion of the price wedge attributable to these barriers. The analysis focuses on the average unit value of 'imports', showing the expected percentage price difference for the same product and origin when imported by the TC economy compared to a similar country. Because TCc 'department of customs' data include cost, insurance and freight (CIF), while BACI data exclude these costs (FOB), adjustments are made using estimated maritime transport costs at 4-digit HS product level.

The findings indicate that 'imported' products face a significant price premium in the TCe, even after accounting for differences in sourcing and quality (Table A2). On average, a product 'imported' into TCe is priced 10–22 percent higher than the same variety imported by peers, after controlling for all relevant factors. This price disparity remains even after correcting for CIF/FOB reporting inconsistencies and adjusting for quality variation. The robustness of these results suggests that the gap is not attributable to sourcing practices or differences in product composition. The exact same product, defined at the HS6 level, originating from the same country and traded in the same year, is more expensive when 'imported' by TCe than by comparable countries. This indicates the existence of regulatory restrictions that raise the cost of entering the TC market, with costs likely passed on to consumers.

Overly restrictive 'trade' measures also appear to contribute to the limited number of firms supplying goods to the TC market, thereby reducing competition. Many agri-food licenses are issued with protectionist intent, regardless of the actual risk level associated with the product.[29] Fruit, vegetables, and meat products are particularly affected by regulatory access barriers. In practice, there is a *de facto* ban on fruit and vegetable 'imports': access to the TC market is permitted only when the local bodies determine that local supply is insufficient. Even then, licenses are granted only for specific quantities. This regime penalizes consumers, who face limited product variety, often of lower quality and at higher prices. At the same time, the lack of competitive pressure weakens productivity incentives for local fruit and vegetable producers, who are shielded from market competition. This curbs their ability to produce food at a quality and price that would enable its 'export' to other economies.

Food products face disproportionate restrictions

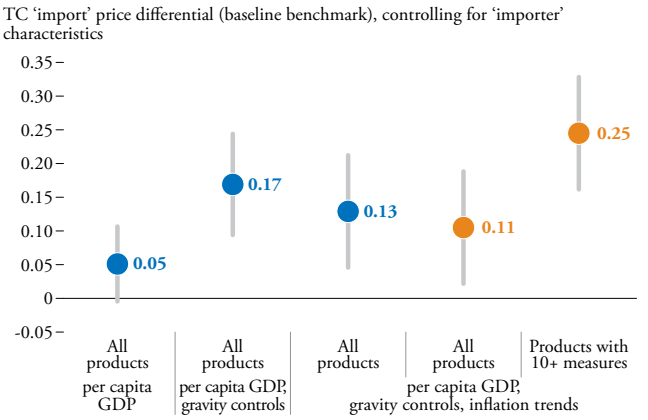
The impact of NTMs is particularly pronounced in highly regulated product groups, amplifying price differences for TC 'imports'. For example, vegetables, fruit and nuts, dairy products, and beverages are among the categories most affected by overlapping NTMs, often including sanitary and phytosanitary (SPS) measures, technical barriers, and licensing requirements. These products, typically subject to public health and quality controls, also face additional non-technical regulatory

28 International trade law permits import restrictions under principles that ensure fairness and non-discrimination. It distinguishes between automatic and non-automatic licenses, with the latter used for specific policy goals. Under GATT Articles I and III, countries must treat all trading partners equally (MFN) and give imported goods the same treatment as domestic ones (NT). Protectionist licensing that favors domestic products violates these principles and undermines global economic development.

29 Products accessing the TC market from the EU countries require a SPS certificate from the originating country. Compliance with the EU or Turkish labeling regulations is also ensured by the local administration for goods accessing the TC market. Microbiological certificates are requested once a year. Lab tests are performed but only on some shipments (no capacity to analyze for heavy metals and GMO presence). Products accessing the TC market from Türkiye have to be heat-treated, depending on the type of product and the region of origin. Lab tests in Türkiye might be required if the product is not heat-treated. Products from other countries are admitted only if the producer can prove to be registered with the EU.

restrictions in the TCe. The severity of controls applied on goods originating from other economies is not applied to controls on goods produced domestically. The combination of higher average NTMs and larger estimated price wedges for these products reinforces the idea that the regulatory burden is not only extensive, but also disproportionately concentrated in sectors of high consumer relevance. Figure 2.6 further illustrates this compounding effect, showing how the inclusion of additional controls, such as NTM frequency, consistently raises the estimated price premium for TC 'imports'.

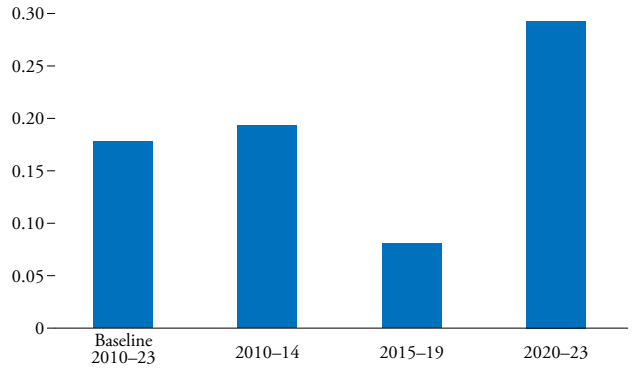
Figure 2.6 Trade regulations raise product prices



Source: World Bank staff calculation based on BACI dataset plus data from TCc 'department of customs'.
Note: This figure summarizes the results from Table A4 by plotting the estimated coefficients on the TC 'import' dummy across various specifications, each controlling for an increasingly comprehensive set of importer characteristics. The two orange markers are derived from the same regression specification, which includes an interaction term between the TC indicator and the level of NTMs applied to the product. The first marker represents the baseline TC 'import' premium, while the second shows the additional price effect for products subject to ten or more NTMs. All regressions include fixed effects for product-year of origin and use two-way clustering. The figure confirms the robustness and persistence of the TC 'import' price premium, even after controlling for GDP, population, inflation, and exchange rate differences.

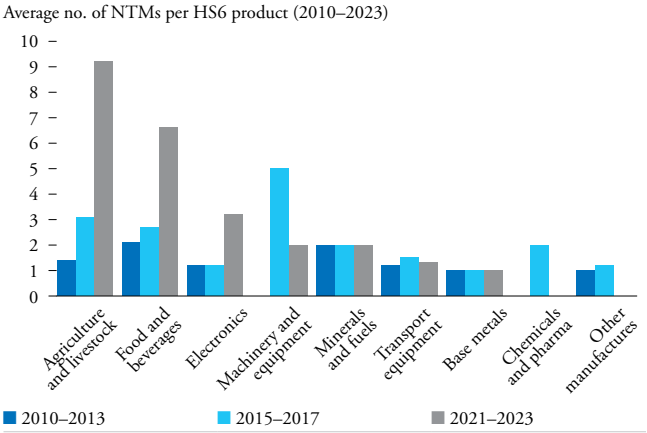
The price differential has persisted over time, remaining consistent from 2010 to 2023. The results, shown in Figure 2.7, confirm that the price wedge is not limited to a single episode but remains evident throughout the entire period. Although the magnitude of the wedge fluctuates over time, the overall pattern is stable, suggesting that regulatory barriers to 'imports' have had a persistent, inflationary impact on trade prices in the TCe. While the econometric model accounts for factors in the importing country (including inflation and macroeconomic shocks), the timing of the price differentials aligns with changes in regulatory enforcement. A tightening of licensing procedures in the mid-2010s and the ongoing application of overlapping agricultural and food NTMs may have played a role in widening the wedge in certain years.

Figure 2.7 TC 'import' price differentials have largely persisted since 2010



Source: World Bank staff calculation based on BACI dataset plus data from TCc 'department of customs'.
Note: This figure shows the evolution of the estimated 'import' price differential for the TC economy over time. Estimates are based on the baseline specification in Column (3) of Table A1 and are split by subperiods within 2010–2023. The results confirm that the 'import' price premium is not limited to a specific episode but is consistently observed across the full sample period, suggesting that regulatory frictions have exerted a persistent upward pressure on prices.

Figure 2.8 Regulatory intensity is highest for agriculture and food products



Source: World Bank staff calculations based on data from local bodies in the TCc issuing pre-permits.
Note: The figure shows the average number of non-tariff measures (NTMs) applied per HS6 product in each product chapter for three periods spanning 2010 to 2023. Regulatory intensity is highest for agriculture and livestock, food and beverages, and transport equipment. These chapters also cover the broadest range of products in 2023, with 90, 12, and 11 unique HS6 items respectively. The combination of high regulatory density and product diversity suggests a disproportionate burden on sectors that are economically and socially important.

The concentration and evolution of regulatory intensity across sectors help explain persistent 'import' price differentials and their variation over time. Figure 2.8 presents the average number of NTMs applied per HS6 product within each chapter for 2010, 2016, and 2023. The data show that regulatory intensity remains consistently highest in key sectors such as agriculture and food. These sectors not only face a denser layering of overlapping NTMs, but also encompass the widest range of 'imported' goods. This pattern supports the view that price differentials are shaped not only by macroeconomic factors or product composition, but also by targeted regulatory practices that disproportionately raise trade costs in strategically important sectors.

Certain non-tariff measures are especially distortionary, driving up 'import' prices significantly. Table A2 breaks down the impact by NTM type, highlighting the categories that impose the highest costs.[30] The estimates indicate that, among the TCe's NTMs, licensing requirements and monitoring or surveillance measures lead to particularly steep import price premiums—58.4 and 33.6 percent, respectively, well above the average across all NTMs. Also SPS measures and technical barriers to trade (TBT), often justified on health or safety grounds, are linked to price increases. These results reinforce the view that current NTM practices create substantial trade costs, potentially deterring 'exporters' from entering the TC market or compelling them to raise prices to compensate for regulatory hurdles. As also observed in other economies, the way NTMs are designed and implemented makes a significant difference to their capacity to restrict trade, suggesting that the policy objective targeted by the NTM could instead be achieved through approaches that don't restrict trade more than is necessary.

The TCe consistently faces higher 'import' prices than regional peers, even under broader benchmarking. Table A3 presents an extended analysis using a comparison group of 10 upper-middle- and high-income economies[31] in Europe and Central Asia. The results remain robust: unit values of TC 'imports' are still 9 to 13 percent higher, depending on the specification. This confirms that the observed price gaps reflect structural features of the TCe 'import' regime rather than the choice of benchmark.

Structural features of the TC 'import' regime contribute to persistent regulatory frictions and elevated trade costs. These features include a licensing system reliant on discretionary approvals, application of risk-based controls limited to 'customs' only, and a high prevalence of overlapping NTMs, even on low-risk goods. Moreover, the lack of digitization and streamlining in NTM administration results in lengthy procedures and heightened compliance burdens for traders. Collectively, these characteristics distinguish the TCe regime from those of benchmark countries, where trade facilitation reforms and adherence to international best practices have reduced import costs and improved transparency.

The persistence of the NTM-related price premium over time underscores the structural nature of these trade frictions. As shown in Figure 2.7, the price gap remained consistently elevated from 2010 to 2023, with only moderate fluctuations that may reflect shifts in enforcement intensity or broader economic pressures. This trend supports the conclusion that these frictions are structural, not cyclical, and may be perpetuated by policy inertia in the absence of reform.

While some NTMs may serve legitimate policy objectives, their cumulative impact highlights the need for comprehensive regulatory review. Streamlining, simplifying or removing redundant measures, particularly those with limited technical justification, could lower trade costs, improve access to a broader range of suppliers, and enhance the overall competitiveness of the TC economy.

30 Some non-tariff measures (NTMs) are clearly used with protectionist intent, particularly those that impose import bans by requiring the issuance of import licenses. These licenses are typically required for agricultural products that are also produced seasonally on the island and are removed when local production is unavailable. This practice significantly distorts both prices and the competitiveness of local production, while also creating additional administrative challenges in managing import quotas when licenses are issued to address perceived local market demand.

31 These include GCe, Greece, Malta, Slovenia, Lithuania, Latvia, North Macedonia, Romania, Bosnia and Herzegovina.

2.3 Policy options for unlocking trade and boosting integration

The policy recommendations presented in this report are primarily addressed to public bodies, who hold the levers to enact structural reforms that can lower trade costs and improve the regulatory and enabling environment for businesses to foster. Unlocking the full potential of the TCe, particularly in areas such as trade integration and competitiveness, will require deliberate, sustained policy action. At the same time, the private sector has a critical role to play. Businesses are not passive recipients of reform, but active agents of change. Their ability to innovate, adapt to shifting market conditions, and engage constructively with regulatory processes is essential for translating policy shifts into real economic gains. Even within today's constraints, the private sector can help shape solutions, including by investing in quality, forging new market linkages, and advocating for practical improvements that support compliance and competitiveness. The recommendations that follow are intended to support a shared agenda for progress, one that invites both sectors to move forward in parallel:

- Simplifying or removing licensing requirements, especially those without clear technical justification, could lower trade costs and consumer prices. Replacing outdated pre-permit systems with risk-based controls at entry points would better align local practices with international standards, enhancing competitiveness and increasing the controls' effectiveness, in the interest of all parties concerned. These reforms would eventually boost the TCe opportunities to trade across the GL.

- Current risk management efforts for goods crossing the GL are a positive start, but deeper integration of technical local bodies in control processes is needed. More specifically, the introduction of the Yellow Lane at the points of entry to the local market has enabled physical checks to be applied only to shipments considered high-risk, significantly reducing the time needed to clear goods. Similarly, the introduction of a Green Lane would consolidate this trend and further improve clearance time.

- Introducing a pilot program to reward compliant 'importers' would encourage better compliance and improve trade efficiency. This is already in use in most economies, where rewarding compliance is recognized as key to achieving the optimal balance between trade facilitation and effective controls. This should be accompanied by an increased attention to punish uncompliant operators, avoiding political interference in applying existing regulations.

- Eliminating unnecessary import licenses could bring economic and administrative benefits, lowering compliance costs, speeding up procedures, and reducing product prices. Local producers would face greater competition, leading to improved productivity and innovation. Additionally, staff involved in licensing could be redeployed to more productive roles, improving administrative efficiency.

- Improving transparency in regulatory requirements is essential for reducing trade costs. Currently, 'import' requirements are scattered across multiple websites in different formats, causing confusion and forcing businesses to seek costly third-party advice. A centralized, user-friendly online portal that organizes requirements by product type and uses internationally recognized HS codes would improve accessibility and compliance.

- There are also needs for the greater balance in regulatory framework with EU which would both improve the competitiveness of manufacturers as well as ensure that domestic production is of a higher quality for consumer protection. The current focus on consumer protection from sub-standard 'imports' diminishes exporters competitiveness.

- Policy decisions could focus on strengthening quality infrastructure, aligning standards, and improving access to market information and finance, especially for firms seeking to enter new markets. In particular, opportunities for producers and exporters to use third-party accreditation bodies to meet compliance requirements of global markets should be explored. Further progress will require stronger coordination and consistent rule application.

- A dialogue across the two communities on how to address the double-VAT issue could unlock further opportunities. Moreover, communication on existing VAT exemptions could be improved.

Annexes

Data sources

This analysis combines detailed trade data with macro and regulatory indicators to examine cross-country variations in 'import' prices and 'export' competitiveness in the Turkish Cypriot (TC) economy.

Bilateral trade data are sourced from the TCc 'department of trade' and the CEPII-BACI international trade database (Gaulier and Zignago, 2010). BACI provides harmonized bilateral trade flows and unit values (US$ per 1000 kg) at the HS 6-digit level, based on reconciled 'import' and 'export' declarations for all UN countries from 1996 to 2023. TCc 'customs' data cover the period 2010–2023 and report bilateral 'import' and 'export' values (in US$) and quantities recorded at the 8- or 10-digit tariff line level in various units (kilograms, liters, units, meters, etc.). To ensure comparability with BACI, TCc data are aggregated to the HS 6-digit level and the analysis focuses on the overlapping period 2010–2023.

Due to differences in measurement units, empirical conversion factors are derived from UN Comtrade mirror flows. Where exporters and importers report different units, global product-specific conversion ratios are used to standardize TCc data to kilograms.

Box A1 Structural Gravity Approach

The structural gravity approach employed in Part II is based on the framework developed by Costinot *et al.* (2012), which extends the classical Ricardian model to a multi-country, multi-sector context. This framework provides a methodology for inferring country-sector productivity from trade data and allows for the decomposition of observed bilateral export flows into three key components: exporter capabilities, importer demand conditions, and bilateral trade frictions.

The following specification is estimated:

$$X_{ij,t} = exp\ (\pi_{i,t} + \chi_{j,t} + Gravity\ Controls_{ij}) + \varepsilon_{ij,t} \qquad (1)$$

where $X_{ij,t}$ represents the value of exports from country i to country j in year. The term $\pi_{i,t}$ captures the exporter's underlying supply-side competitiveness, while $\chi_{j,t}$ reflects the size and accessibility of the importing market. The vector $Gravity\ Controls_{ij}$ includes bilateral trade costs such as geographical distance, common language, historical ties, and the presence of preferential trade agreements. The term $\varepsilon_{ij,t}$ denotes the random error term component.

This methodology enables the construction of a revealed export competitiveness index, $\pi_{i,t}$, which reflects an economy's capacity to supply goods that are competitive in global markets, holding constant the characteristics of destination countries and trade frictions. The index is constructed using only the set of products that each country actually exports, thereby ensuring that cross-country comparisons are based on observed rather than potential export baskets. This approach provides a consistent basis for ranking export performance across countries.

This reflects the CEPII-BACI approach, which also harmonizes quantities to allow unit value comparisons.

Additional control variables include bilateral trade cost indicators (e.g. distance, common language, shared colonial history, and regional trade agreements) from the CEPII Gravity Database (Conte *et al.*, 2022). Macroeconomic indicators such as exchange rates and GDP per capita are taken from the Penn World Tables v10.1 (Feenstra *et al.*, 2015), while World Bank classifications are used to define benchmark comparator economies (e.g., upper-middle-income countries in Europe and Central Asia).

Supplementary indicators of language proximity are taken from Gurevich *et al.* (2024), and trade cost adjustments use estimates of maritime transport costs at the HS4 level (Mayer *et al.*, 2023).

All regressions include product-origin-year fixed effects and apply two-way clustering at the exporter-importer-product and importer-product-year levels. The dependent variable is the log of unit values. Regressions are re-estimated using quality-adjusted unit values following Khandelwal *et al.* (2013). Benchmark price comparisons are restricted to a selected set of economies with similar income levels and geographical characteristics, as defined in the benchmarking strategy presented in Part II.

Regression results

Table 3 reports the results of the main regression for the extended sample of comparator economies. The dependent variable is the log of import unit values at the product-origin-year level. The key explanatory variable, TCc 'imports', is a dummy equal to 1 if the importing country is the Turkish Cypriot economy and 0 otherwise. Columns (1)–(3) report estimates using different model specifications, while Columns (4) and (5) introduce sample restrictions or weighting.

Column (1) presents the baseline estimation without any price adjustment. In Column (2), prices are adjusted for CIF/FOB differences using transport cost corrections. Column (3) incorporates quality adjustments following Khandelwal *et al.* (2013). In Columns (4) and (5), the regressions are re-estimated using 2010 import weights.

Across all specifications, the coefficient on TC 'imports' remains positive and statistically significant (at the 1 percent or 5 percent level), indicating that import prices in the TC economy are consistently higher than in comparator economies, even after adjusting for transport costs, product quality, and macroeconomic conditions. The results confirm the robustness of the price wedge associated with TC import regulations, which ranges from approximately 6 percent to 13 percent, depending on the specification.

Table 4 provides further insights by extending the baseline regression with additional importer-level controls. The results in columns (1)–(4) introduce covariates such as the log of GDP, population, inflation (normalized to 2017), and an interaction between TC 'imports' and a product-level count of specific NTMs (column 4).

The inclusion of these controls allows for a richer examination of whether macroeconomic characteristics or regulatory density amplify the observed price wedge. Notably, the interaction term between TC 'imports' and NTM by product is positive and statistically significant, suggesting that the price differential is greater for products with a higher number of NTMs. This confirms that regulatory complexity is an important contributor to the observed increase in import costs.

The consistency of the results across different specifications and control sets reinforces the conclusion that the TC economy faces systematically higher 'import' prices due to regulatory constraints, and that this effect is particularly pronounced in the presence of product-specific NTMs.

Table 5 reports the results of the structural gravity model used to estimate bilateral trade flows in the presence of standard trade cost variables and multilateral resistance terms. The dependent variable is the value of exports from country i to country j in year t, as in equation (2). All regressions include exporter year and

Box A2 Structural Gravity Model Estimation

Gravity models are widely used to analyze trade patterns and identify price and volume barriers. Based on the idea that trade rises with economic size and falls with frictions, structural gravity—highlighted by Anderson (2024)—provides a clear framework for inferring regulatory impacts from observed flows. This is especially useful for assessing whether high import prices in the TC economy reflect sourcing decisions or deeper systemic barriers.

The following model has been estimated:

$$\log (unit\ value)_{ijk,t} = \delta_{ik,t} + \beta_1 NTM_{TCCk,t} + \beta_k Gravity\ Controls_{ijk,t} + \beta_s Destination\ Controls_{jk,t-5} + \varepsilon_{ijk,t} \quad (1)$$

where $NTM_{TCCk,t}$=1 is a dummy variable equal to 1 when the TC economy is the 'export' destination and the product k is subject to 'import' regulation, and 0 otherwise. This captures the average import price wedge from ten broad regulations applied across all imported products in the TC market. The fixed effects $\delta_{ik,t}$ control for origin-product-year variation, thereby isolating destination-specific effects.

Control variables include gravity controls (e.g., distance, trade agreements, currency unions) that capture market integration and transaction costs, and destination controls (e.g., exchange rates, GDP, population, price levels, lagged by five years) reflecting macroeconomic conditions. For the TC economy, a quasi-preferential trade arrangement with Türkiye is assumed, using the Turkish Lira exchange rate. Fixed effects at the product-year-origin level ensure the exchange rate coefficient captures relative movements between economies over time.

TC customs data report 'imports' on a CIF basis, while BACI data are reported on an FOB basis. To reconcile this, benchmark country unit values are adjusted using maritime transport cost estimates at the 4-digit HS level, following Mayer *et al.* (2023). To account for potential quality differences, the analysis is replicated using quality-adjusted unit values, based on Khandelwal *et al.* (2013).[32] This adjustment helps separate cost-increasing distortions (e.g., NTMs) from price differences due to quality. The results show that even after accounting for quality, a significant price gap remains, suggesting that regulatory barriers, rather than quality differences, contribute to higher import costs in the TC economy.

The identification strategy uses a fixed effects estimator that removes confounding variation at the level of the fixed effect $\delta_{ik,t}$, enabling identification of the average price gap for TCc-'imported' varieties, conditioned on product, origin, and year. This structure allows comparison of a given HS6 product imported from the same origin economy in the same year across TCc and non-TCc destinations.

importer year fixed effects to control for the size of the origin and destination markets, price indices, and other macroeconomic factors.

The results are consistent with gravity theory: bilateral distance is strongly negative and highly significant, while preferential trade agreements (RTAs), colonial ties, and geographical proximity are positively associated

32 This method estimates a quality index based on consumer demand behavior within a constant elasticity of substitution (CES) framework, where higher quantities sold at a given price are interpreted as reflecting higher underlying quality. In their study of Chinese exporters, Khandelwal et al. show that failing to account for quality differences can lead to biased conclusions about the impact of trade barriers on prices and productivity.

with trade volumes. Interestingly, the coefficient on "geographical proximity (UN)" is negative and significant, reflecting the fact that this variable may proxy for politically sensitive or administratively complex neighborhood relations.

The estimates remain stable across specifications and are robust to the exclusion of zero trade flows (column 4). These results confirm that the model successfully identifies the key determinants of bilateral trade frictions and provides a reliable basis for simulating counterfactual trade flows—especially in the assessment of missing sales across the Green Line, presented in Section 2.2.

Table A1 The burden on import regulations, TC import prices (unit values) differentials

	(1)	*(2)*	*(3)*	*(4)*	*(5)*	*(6)*
Variables	***(log) Unit Values***			***(log) Unit Values, CIF corrected***	***(log) Unit Values, quality adjusted***	
TC 'imports'	0.168***	0.208***	0.178***	0.110***	0.180***	0.221***
	(0.029)	(0.056)	(0.039)	(0.039)	(0.039)	(0.054)
Exchange Rate destination		0.004	0.013***	0.013***	0.015***	0.012***
		(0.002)	(0.001)	(0.001)	(0.001)	(0.001)
PTA		-0.011	-0.014	-0.010	-0.049	-0.138**
		(0.075)	(0.048)	(0.048)	(0.044)	(0.066)
Common Currency		0.044	0.000	-0.005	-0.387***	-0.401***
		(0.049)	(0.037)	(0.038)	(0.035)	(0.055)
(log) Distance			0.142***	0.142***	0.171***	0.231***
			(0.009)	(0.009)	(0.008)	(0.020)
Observations	29,082	29,082	359,049	359,049	349,569	349,569
R-squared	0.822	0.823	0.800	0.795	0.883	0.882
FE	ikt	ikt	ikt	ikt	ikt	ikt
Cluster	ijk jkt	ijk jkt	ijk jkt	ijk jkt	ijk jkt	ijk jkt
Weights	No	No	No	No	No	TCc import 2010
Sample	restricted	restricted	baseline	baseline	baseline	baseline

Note: Standard errors in parentheses, two-way cluster at the exporter-importer-product and importer-product-year level, *** p<0.01, ** p<0.05, * p<0.1. In columns 1 and 2, the benchmark is the GCe; in columns 3 to 6, the benchmark countries are the RoC, Greece, Malta, and Slovenia.

Table A2 The burden on 'import' regulations, TC 'import' price differential by NTM type

NTM Type (Code):	*SPS (A)*	*TBTs (B)*	*Licensing (E)*	*Monitoring (C/F)*
Estimated Coefficient:				
NTM Type	0.077*	0.346***	0.465***	0.295***
Remaining Types	0.416***	0.133***	0.145***	0.238***
Specification	Baseline gravity, full set of Controls, FEs: ikt			
Price Difference NTM Type	7.3	40.5	58.4	33.6

Note: Table 2 disaggregates the price effect by type of non-tariff measure (NTM), using categories aligned with UNCTAD's TRAINS classification. The table reports the estimated coefficients for products subject to SPS (code A), TBTs (code B), licensing (code E), and monitoring/surveillance (code C/F). The specification corresponds to Column (3) of Table 2 and includes the full set of gravity controls and fixed effects. The results indicate that licensing and surveillance-type NTMs are associated with the highest price premiums (58.4 and 33.6, respectively). These findings suggest that non-technical, protectionist measures are key contributors to elevated trade costs in the TC economy. The price effect is calculated as [exp(β(NTM,TCC))-1]*100.

Table A3 The burden on 'import regulations', TC 'import' prices (unit values) differentials for 10 comparator countries

	(1)	*(2)*	*(3)*	*(4)*	*(5)*
Variables	*(log) Unit Values*		*(log) Unit Values, CIF corrected*		*(log) Unit Values, quality adjusted*
TC 'imports'	0.036	0.125***	0.055*	0.113**	0.097*
	(0.026)	(0.029)	(0.030)	(0.058)	(0.055)
Exchange Rate destination		0.005***	0.005***	0.004***	0.006***
		(0.000)	(0.000)	(0.001)	(0.001)
PTA		0.063***	0.062***	-0.009	-0.205***
		(0.020)	(0.020)	(0.040)	(0.044)
Common Currency		0.033***	0.032***	0.035	-0.109***
		(0.009)	(0.009)	(0.028)	(0.021)
(log) Distance		0.181***	0.181***	0.224***	0.374***
		(0.006)	(0.006)	(0.016)	(0.013)
Observations	748,551	748,551	748,551	748,551	637,918
R-squared	0.760	0.762	0.756	0.764	0.862
FE	ikt	ikt	ikt	ikt	ikt
Cluster	ijk jkt	ijk jkt	ijk jkt	ijk jkt	ijk jkt
Weights	No	No	No	TCc import 2010	TCc import 2010
Sample	extended	extended	extended	extended	extended

Note: Standard errors in parentheses, two-way cluster at the exporter-importer-product and importer-product-year level, *** p<0.01, ** p<0.05, * p<0.1.

Table A4 The burden on 'import' regulations, TC 'import' price differential (baseline benchmark), controlling for 'importer' characteristics

	(1)	*(2)*	*(3)*	*(4)*
Variables		***(log) Unit Values***		
TC 'imports'	0.051*	0.169***	0.129***	0.105**
	(0.028)	(0.040)	(0.042)	(0.046)
TC 'imports' * NTM by product				0.014***
				(0.005)
(log) GDP importer	0.242***	0.197***	0.220***	0.221***
	(0.020)	(0.019)	(0.022)	(0.022)
(log) POP importer	-0.293***	-0.251***	-0.269***	-0.269***
	(0.020)	(0.020)	(0.022)	(0.022)
Inflation (2017 = 1)			-0.120***	-0.129***
			(0.044)	(0.045)
Exchange Rate destination		0.013***	0.012***	0.013***
		(0.001)	(0.001)	(0.001)
PTA		-0.039	-0.037	-0.030
		(0.048)	(0.048)	(0.048)
Common Currency		0.014	0.015	0.012
		(0.037)	(0.037)	(0.038)
(log) Distance		0.152***	0.155***	0.157***
		(0.009)	(0.009)	(0.009)
Observations	359,049	359,049	359,049	359,049
R-squared	0.800	0.801	0.801	0.801
FE	ikt	ikt	ikt	ikt
Cluster	ijk jkt	ijk jkt	ijk jkt	ijk jkt
Weights	No	No	No	No
Sample	baseline	baseline	baseline	baseline

Note: Standard errors in parentheses, two-way cluster at the exporter-importer-product and importer-product-year level, *** p<0.01, ** p<0.05, * p<0.1.

Table A5 Structural gravity estimations

	(1)	*(2)*	*(3)*	*(4)*
Variables	$X_{ij,t}$ ***sales from country*** i ***to country*** j ***at time*** t			
log(Distance)	-0.846***	-0.847***	-0.842***	-0.843***
	(0.065)	(0.065)	(0.064)	(0.064)
Geographical Proximity	0.566***	0.568***	0.568***	0.569***
	(0.126)	(0.126)	(0.125)	(0.125)
Geographical Proximity (UN)		-3.393***		-3.429***
		(0.560)		(0.546)
Language Proximity	-0.151	-0.152	-0.151	-0.151
	(0.248)	(0.248)	(0.245)	(0.245)
RTA	0.375***	0.372***	0.374***	0.372***
	(0.099)	(0.099)	(0.097)	(0.097)
Colonial Ties	0.425*	0.420*	0.417*	0.412*
	(0.223)	(0.223)	(0.221)	(0.221)
Observations	359,049	359,049	359,049	359,049
R-squared	0.800	0.801	0.801	0.801
FE	exporter-year importer-year			
Cluster	exporter and importer			
Sample	including zeros		only positive sales	

Note: Standard errors in parentheses, two-way cluster at the exporter-importer-product and importer-product-year level, *** p<0.01, ** p<0.05, * p<0.1.

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