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YÜKSELMEKTE OLAN BİR EKONOMİ TÜRKİYE İLE KÜÇÜK BİR ADA EKONOMİSİ OLAN KUZAY KIBRIS'IN EKONOMİK İLİŞKİLERİNİN İNCELENMESİ: DIŞ YARDIM VE İKTİDAR PARTİLERİNİN İDEOLOJİSİ

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ÖZET

Anahtar Kelimeler:

- ❖ Dış yardım,
- ❖ Politik iktisat,
- ❖ ARDL yaklaşımı

Bu çalışma, Türkiye ve KKTC iktidar partilerinin siyasi uyumlarının Türkiye'den KKTC'ye yapılan dış yardım üzerindeki etkisini araştırmaktadır. Değişkenlerin durağanlığına bağlı olarak, 1983-2017 döneminde KKTC'ye yapılan dış yardım ile iktidar partileri arasındaki siyasi uyum arasındaki ilişkiyi incelemek için ARDL yaklaşımı kullanılmıştır. Elde edilen sonuçlara göre, iktidar partilerinin siyasi uyumu ile dış yardımlar arasında uzun dönemde bir ilişkinin olduğu tespit edilmiştir. Bulgulara göre, iki ülkenin iktidar partileri benzer siyasi görüşe sahip olduğunda, KKTC'nin kişi başına düşen GSYİH, KKTC enflasyonu, Türkiye'nin devlet harcamaları ve ekonomik kriz etkisi kontrol edildikten sonra bile Türkiye'den KKTC'ye yapılan dış yardımın önemli ölçüde arttığını göstermektedir.

THE ANALYSIS OF THE ECONOMIC RELATIONSHIP BETWEEN AN EMERGING ECONOMY TURKEY AND SMALL ISLAND NORTHERN CYPRUS: RULING POLITICAL PARTIES, THEIR IDEOLOGIES AND FOREIGN AID

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ABSTRACT

This study investigates the effect of political alignment of ruling parties of Turkey and TRNC on the foreign aid from Turkey to TRNC. Depending on the stationarity of the variables ARDL approach is used to examine the relationship between political cohesion between ruling parties and the foreign aid to TRNC for the period from 1983 to 2017. According to the results, it is found out that a long-run relationship exists between foreign aid and alignment of ruling parties of two countries. The findings suggest that, when the ruling parties of two countries have similar political view, the foreign aid from Turkey to TRNC significantly increases, even after controlling GDP per capita of TRNC, inflation of TRNC, government expenditure of Turkey and economic crisis effect.

Keywords:

- ❖ Foreign aid,
- ❖ Political economy,
- ❖ ARDL approach

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INTRODUCTION

Foreign aid was formed with the theoretical foundations of development economics. After World War II, it became widespread as a tool of diplomacy with the bipolar world order. By entering the institutionalization process with the establishment of the DAC (Development Assistance Committee) of the OECD (The Organisation for Economic Co-operation and Development), foreign aid formed a critical bond between countries. While foreign aid is seen as a critical bond instrument in international relations and as a mean of development, the foreign aid between Turkey and TRNC can also be characterized as a manifestation of historical and cultural cooperation between them. Moreover, the multidimensional and close relationship between the TRNC and Turkey can be seen in regional and global politics as well as in economic, financial, social and cultural fields.

Foreign aid from Turkey to the TRNC is an important element of this multidimensional relationship. Within the framework of three-year economic programs, financial and technical support is provided from Turkey to the TRNC. Üçkuş (2018) suggests that the main aim of this support is to reduce the costs of isolations and the embargo, which is the result of the TRNC's international non-recognition. Furthermore, he also claims that establishing an institutional structure in the TRNC is another goal of the foreign aid from Turkey to TRNC.

Foreign aid, which is extremely important for the TRNC economy, can be affected by the political relations between the two countries. To be more specific, considering that the most important determinants of political relations between countries are the ruling political parties, it can be expected that the relations and the alignment of the ruling parties can also affect the aid policy between Turkey and the TRNC. In other words, as long as the ideologies of ruling parties go along, more coherent and efficient foreign aid policies can be determined between Turkey and TRNC. It is especially important for the TRNC to

determine whether the foreign aid, which has a serious effect on the economy and policy of the TRNC, is determined regarding to the cohesion of the ruling parties' ideologies. In this manner, if the amount of aid is determined according to the alignment of the political views of the ruling parties, this may cause the aid to be interrupted in the future in case of any possible political incompatibility of the ruling parties. This situation may cause irreversible economic and political problems for the TRNC. From this point of view, the effect of political views of the ruling parties on the foreign aid amount is one of the topics that can be investigated. However, to the best of our knowledge, there is no study in the literature on whether the foreign aid policy between the Turkey and TRNC is affected by the political views of the ruling parties. In this manner, it is thought that this study will fill out an important literature gap.

In this study, it has been examined whether the aid from Turkey to the TRNC changes according to the ideological alignment of the ruling parties in these countries for the period from 1983 to 2017. Empirical findings suggest that the ratio of foreign aid to TRNC GDP (Gross Domestic Product) is affected by the political views of the ruling parties in both countries. Specifically, the ratio of aid to the GDP of the TRNC increases in years when the political views of the ruling parties are similar. This study consists of five main parts; literature review, theoretical framework, data and empirical methodology, empirical results and conclusion.

1. LITERATURE REVIEW

Cyprus is an island which is located in the Eastern Mediterranean between latitudes 34.33 and 35.41 north and longitudes 32.17 and 34.35 east. After Sicily and Sardinia, it is the Mediterranean's third-largest island. The area of Cyprus is 9,251 km² and its length between the east-west end is 225 km while its width is 96.5 km. Cyprus' strategic importance originates from its geographical location, which allows it to dominate the Eastern Mediterranean and trade routes that travel through it. Moreover, lately, there has been

a noticeable increase in the strategic importance of the island with the discovery of natural resources in the Eastern Mediterranean region. According to Çevikel (2000) and Özarslan (2007) the question of why Cyprus has geopolitical importance can be answered as follows. Firstly, Cyprus takes place on the transportation route of the oil extracted in the Middle East. Secondly, Cyprus controls the Anatolia-Middle East-Suez Canal route and is one of the control points for the maritime route from the Suez Canal to the Indian and Pacific Oceans. Lastly, the authority dominating the island has an opportunity to have a prestige on Middle Eastern states.

Before starting the literature review, it should be noted that the literature on the TRNC economy is very scarce. Additionally, studies on small island countries and foreign aid are also very scarce. The joint report of Eastern Mediterranean University and Prime Ministry (2015) suggests that the TRNC economy, which has small island economy features, has a small-scale domestic market, limited natural resources, and a micro-economic structure mainly based on service production. Additionally, the report states that similar to other countries with small economies, TRNC aims to develop its economy by gaining access to international markets and increasing foreign demand. However, the continuing Cyprus problem makes it difficult to access foreign markets and also it harms the investment climate of the TRNC. On the other hand, Üçkuş (2018) states that the excessive volume of the public sector, high budget deficit, and the high foreign trade deficit are the main handicaps of the country's economy. Moreover, he states that staff and transfer expenditures make up the bulk of the budget. In other respects, as TEPAV (The Economic Policy Research Foundation of Turkey) (2012) report indicates, the exclusion of the private sector due to structural defects in public finance (crowding-out effect) is one of the important problems in the TRNC economy. This condition of public finances leads to a dependency on foreign aid and an unsustainable economic situation.

Üçkuş (2018), also touches upon the role of foreign aid in the TRNC's economy. He indicates that financing from Turkey is needed to make current expenditures, investments, and support the private sector. Similar to Üçkuş (2018), the joint report of EMU (Economic and Monetary Union) and Prime Ministry (2015) suggests that loans given by Turkey to finance the current account deficit and the budget deficit and also the aid provided by Turkey for the realization of infrastructure investments provide significant capital inflows to the TRNC economy.

Şafaklı and Özdeşer (2002) mention the effectiveness of TRNC's monetary policies. They state that the control of the Turkish Lira, the official currency of the TRNC, is entirely in the hands of the Central Bank of the Republic of Turkey. They claim that this situation eliminates the effectiveness of the monetary policies and foreign trade policy of the TRNC.

What is more, while evaluating the general situation of the TRNC economy, it is necessary to mention the embargoes that directly affect the economy of the country.

As Eroğlu (2002) states, after the establishment of the TRNC on November 15, 1983, with the decision dated 18.11.1983 and numbered 541 taken by the UN Security Council, the foundation of the TRNC was declared invalid and unfair. Moreover, other states were called upon not to recognize a state other than the Republic of Cyprus. This decision of the Security Council has been fully adopted by the European Economic Community. Reçber (2013) suggests that, although there is no legally declared embargo against the TRNC, there are many international law subjects who impose an embargo, not legally, but practically, by not doing foreign trade with the TRNC, not allowing direct flights to the TRNC, and not including the TRNC in sporting events.

In this sense, international law subjects, who do not recognize the TRNC, act in accordance with all the conditions required by the act of non-recognition. Due to this attitude of the Security

Council, no country other than Turkey recognizes the TRNC.

Apart from the above-mentioned embargoes, the real blow to the TRNC economy is the decisions taken by the Court of Justice of the EU in 1994.

Reçber (2013) says that, on July 5, 1994, the Court of Justice of the EU decided to prevent the export of TRNC-origin agricultural products from the TRNC to EU member states, which do not rely on documents approved by the GCA of Southern Cyprus. TRNC has been negatively affected by this situation in terms of the economy. Şafaklı and Özdeşer (2002) state that, TRNC exports recorded a serious decline with the effect of embargo decision taken by the Court of Justice of the EU in 1994. In addition, according to Şafaklı and Özdeşer (2002), another problem in TRNC foreign trade is that the EU market, which is an important market for the TRNC, follows a policy based on protectionism in terms of agricultural products. On the other hand, Aran (2018) suggests that The Court of Justice of the EU has not officially imposed an embargo on the products to be imported from the TRNC. However, as a result of the decisions taken by the ECJ (European Court of Justice), the possible export of goods from the TRNC to European countries has become impossible.

From a different and critical point of view, TEPAV (2012) report remarks that the reason for the current structure of the Northern Cyprus economy is not only the Cyprus problem and isolations but also the lack of a consistent development vision.

According to TEPAV (2012) report, TRNC, which has been isolated from the European markets to which it has been integrated in the past, has only a domestic market and merely the public sector has flourished in the country. However, this does not necessarily mean not to discuss under what conditions and in which niche areas the TRNC can be competitive in the markets of countries. Moreover, it has been believed that the existing problems could be solved with foreign aid. This thought put also another obstacle to generate a

creative vision and policy framework to compete in new markets, and as a result, any attempt to convert isolation into an advantage has not been taken. As a result of this situation, an economic structure reliant on public funds and foreign aid from Turkey has emerged. An approach focusing on non-tradable activities has inevitably produced an economy dominated by civil servants (TEPAV, 2012).

After investigating the features of TRNC economy, the foreign aid based economic relationship between Turkey and TRNC is examined below.

One of the main reasons for Turkey's support of the TRNC is Turkey's historical and cultural ties with Cyprus and Turkish Cypriots. As mentioned in the previous parts of the study, these historical ties were established after the Ottoman Empire conquered the island in 1571. Between 1963-1974, the relationship between the two communities gradually strengthened and reached a peak with the intervention of Turkey in 1974. Not only the historical ties among two countries but also the geopolitical importance of TRNC can be accepted as a reason of Turkey's serious support to TRNC. TRNC is located at a critical point in the Eastern Mediterranean. Moreover, the strategic importance of TRNC has been raised by the force of discovery of natural resources in the Eastern Mediterranean region. Under these circumstances, TRNC strengthens the hand of Turkey in that region since TRNC is one of the most important allies of the Turkey. Lastly, the various embargoes imposed on the TRNC since its establishment and the problem of not being recognized by other countries (except Turkey) can be considered as other reasons for Turkey's support.

During this period, the Cyprus Coordination Committee and the Presidency of the Turkish Republic Aid Delegation were established to support the functioning of the economic, political, and social life of the Turkish Cypriots and to ensure the planning and coordination of the aid to be provided by Turkey. Kendirci (2012) indicates that, after the establishment of the Turkish

Federated State of Cyprus, the first official foreign aid to the Turkish Cypriots started with the Trade and Payment Protocol signed on July 18, 1975. The protocol has aimed to improve economic and commercial relations between the two countries and to overcome the de facto embargoes and isolations imposed on Turkish Cypriots.

In his study, Kendirci (2013) examines the institutions, agreements, and the purposes of aid transfer process from Turkey to TRNC. He states that the aid relationship which started in 1974, continued until 1997 via bilateral protocols. With the Economic Cooperation Protocol signed in 1997, the nature of aid cooperation changed. As of this date, Turkey started to make a commitment to aid for certain periods, while the TRNC side made a commitment to carry out structural reforms. Kendirci (2013) remarks that, until 2001, the aid cooperation between the two countries was maintained within the framework of the agreements signed. Since 2001, the aid cooperation has been maintained with the Economic Programs included in the annex of the Economic and Financial Cooperation Protocol. According to him, with the Economic Programs, it was aimed to create a competitive and sustainable structure with a strong economy. In this context, parameters and targets that will ensure the structural economic transformation of the TRNC have been determined and Economic Programs have been designed within this framework. Similar to Kendirci (2013), in his study, Üçkuş (2018) gives place to the common content of the economic programs implemented after 2001. He states that, through programs, it is aimed to restructure the public sector and the financial sector. This restructuring, first of all, it is aimed to reduce the share of the public in the economy. Secondly, a more competitive economy requires to support the real sector. Among many real sectors, tourism and higher education are two of mostly focused sectors in the new restructuring period. Especially the remarkable contribution of the tourism sector to the economy since 2007 gives a sign of how successful the restructuring period has been.

One of the most important economic constraints faced by the TRNC arises from the fact that it has a Small Island (Country) Economy.

According to a UN report, dated 1983, Small Island Economies are suffered from isolation, limited transportation and communication facilities, limited domestic market, lack of marketing experts, limited natural resources, export structure based on a few products, and heavy financial burdens (Karaman, 2005). In this context, Collier and Dollar (1999) remark that small island economies are vulnerable to external shocks and the effects of forces beyond their control. Thus, foreign aid and aid management produce an important effect on small island economies such as the TRNC.

Additionally, foreign aid is important in terms of revitalizing the private sector in small island economies and increasing private sector investment expenditures. Üçkuş (2018) mentions that aid from Turkey plays an important role in the TRNC economy by improving production facilities, increasing the share of the private sector in the economy, establishing a competitive economic structure, and supporting the real sector in total. According to him, not only aids, but also the execution of economic programs (in which aids are organized and determined), technical cooperation between the two countries and projects for infrastructure have an important place in the TRNC economy. In this respect, Turkey finances many infrastructure investments in all sectors, especially the Water Supply Project and the E-Government Project.

Furthermore, Turkey supports real sector projects to ensure the development of the private sector. Just like Üçkuş (2018), in his study, Kendirci (2013) also mentions that the content of aid from Turkey and remarks on the importance of aid for the economy of TRNC. Kendirci (2013) points out that, since 2001, 3-year economic programs have been implemented within the framework of the protocols signed between the two countries. It is clear that the implementation of these programs contributes positively to the TRNC economy. He claims that, apart from the aids reflected in the

budget (via programs), Turkey provides assistance to ensure the sustainable development of the TRNC economy. Particularly, the project of "Bringing Water to TRNC from Anamur Stream with a Pipe" which costs more than 1 Billion Turkish Lira and is expected to bring annual 75 Million m³ water is very crucial not only in terms of its contributions to the TRNC economy but also strengthening the ties between Turkey and TRNC. Moreover, Kendirici (2013) adds that the project that aims to bring electricity to the TRNC by cable will also be beneficial for TRNC in terms of reducing the input costs.

In addition to the importance and benefits of aid for the TRNC economy, Üçkuş (2018) discusses the aid relationship between the two countries from a different perspective. According to him, especially in periods when economic programs are not implemented meticulously, the aids may have an effect on the increase of the public's share in the economy, the reluctance in tax collection, and the use of resources for inefficient public expenditures.

As it is seen from the literature review, there is a very limited literature about economic relationship between Turkey and the Turkish Republic of Northern Cyprus and exists no any empirical study that examines how the political views of the ruling parties influence foreign aid between two countries. From this point of view and to the best of our knowledge, this study will fill out an important literature gap.

2. THEORETICAL FRAMEWORK

Foreign aid, without a doubt, encourages the pursuit, promotion, and protection of the donor country's national interests. According to Gulrajani and Calleja (2019), no country would offer help unless it was representing, or at the very least be respectful of, its own concerns and goals. Dreher et. al (2015) state that, although the implications of foreign aid for political and economic reasons have been extensively studied, the effect of the political ideology of donor and recipient governments has received little

attention. There are few numbers of studies which test the effect of political proximity between donors and recipients on foreign aid.

It is expected that the political proximity is one of the factors that augment the amount of foreign aid. According to Dreher et al. (2015), one fact that support this suggestion is that political misalignment between donor and recipient governments may cause transaction costs to increase and furthermore, it will give rise to incentive problems. Noël and Thérien (2000) approach from a different perspective and suggest that while left-wing governments could end with higher foreign aid due to their perception of solidarity, right-wing governments could also agree on higher foreign aid due to their understanding of brotherhood.

As a matter of fact, Alesina and Dollar (2000) state that the direction of foreign aid is determined not only by economic needs but also by political considerations. Similarly, Dreher and Jensen (2007) find out that political allies of the IMF's most prominent shareholders obtain loans with lighter circumstances. Additionally, Nielsen (2013) reaches the same results and suggests that reducing aid due to human rights violations is only the case when donor and recipient countries are not allies. Moreover, Alesina and Dollar (2000) find out that recipient countries obtained more aid from all top donors when voting in line with the donor country in the UN General Assembly. All of these empirical results show that the political alignment of governments does matter for foreign aid.

On the other hand, as Brech and Potrafke (2014) state, political alignment of governments is especially effective on grant type foreign aid rather than loan aid. According to Odedokun (2003) and Odedokun (2004), grants are more likely to exhibit partisan effects compared to loans. This is the fact because grant aid is so similar to domestic social welfare payments. Grants may be more closely aligned with redistributive goals than loans, which must be repaid over time. According to Rajan (2005), the partisan effect is likely to be more

pronounced in the grant time series since loan payments are affected by additional confounds such as the risk of debt default and the complex economics and politics of debt relief. As a result, a simple time series of annual extended loan payments is likely to provide a partial picture of donor opinions toward future loan recipients. These theoretical and empirical evidence show that political proximity is one of the factors that determines the amount of aid from donor to recipient countries.

This study investigates whether ideological alignment of the ruling parties in Turkey and TRNC is a significant determinant of the amount of aid from Turkey to TRNC. In other words, this study examines whether the amount of aid when both of the governments of Turkey and TRNC are right wing or both of the governments are left wing is higher than the amount of aid when one of them is left-wing, the other is right-wing.

In the study, following Lensink and Morrissey (1999), total aid as a share of GDP is used as the dependent variable, because it captures not only the amount of aid but also the relative importance of aid inflows for TRNC. Although it can be argued that this variable is subject to change even if aid stays constant but GDP of TRNC changes because our main study of interest is to test the instability of aid from Turkey to TRNC capturing the importance of the aid, is more appropriate than just using the sole aid amount.

Moreover, several factors' effect should be controlled to study this relationship. The economic health of the recipient country is especially significant on aid to TRNC, because of the historical roots of the relationship between Turkey and TRNC. In line with Dreher et. al (2015) GDP per capita of TRNC is added as a control variable. In addition to the GDP per capita of TRNC, inflation of TRNC is also added as a control variable, since inflation is one of the best indicators that reflects the economic stability and economic health of the countries.

Noël and Thérien (2000) claim that some institutional variables may also account for foreign aid. They specifically suggest that social-democratic welfare state institutions might affect the amount of foreign aid. This effect can be proxied by government spending as a share of GDP because it is expected that the higher the welfare state institutions the higher the share of government spending will be. Because it is likely that this institutional effect is related to political ideology of government, this effect should also be controlled as in the study of Noël and Thérien (2000). Therefore, the total government spending of Turkey as a share of its GDP is added as control variable to the equation.

3. DATA AND EMPIRICAL METHODOLOGY

The data set used in this model consists of annual data regarding the TRNC and Turkey's economy starting from 1983, the establishment date of the TRNC, and continues until 2017. It ends in 2017 since the data on foreign aid from Turkey to the TRNC has not been released from 2017 onwards.

GDP, inflation and population data of TRNC are taken from the TRNC State Planning Organization's official report, Economic and Social Indicators Report, published in July 2020. Aid data is received from the 2018 official report of the Office of Development and Economic Cooperation working under the Nicosia Embassy of the Republic of Turkey.

This report contains the data set showing the total grants and loans given by Turkey to the TRNC. Only the total grants part in this data set is used and evaluated as aid data.

The data of Turkey's government expenditures as a share of GDP is obtained from the official website of World Bank. The data of ruling political parties in TRNC is perceived from the official website of TRNC prime ministry. The data of ruling political parties in Turkey is taken

from the official website of the Grand National Assembly of Turkey.

The descriptive statistics of the study is reported in Table 1.

Table 1. Descriptive Statistics

| Variables | Mean | Median | St. Dev. | Skewness | Kurtosis | Min | Max | Jarque-Bera | Prob |
|-----------|----------|----------|----------|----------|----------|---------|----------|-------------|-------|
| AID/GDP | 0.080 | 0.075 | 0.028 | 1.057 | 4.551 | 0.044 | 0.17 | 10.023 | 0.007 |
| GDP/POP | 6810.422 | 4375.250 | 4609.178 | 0.398 | 1.482 | 1250.10 | 14421.78 | 4.284 | 0.117 |
| GOV/GDP | 0.120 | 0.126 | 0.022 | -0.719 | 2.590 | 0.075 | 0.15 | 3.257 | 0.196 |
| INFLATION | 0.421 | 0.430 | 0.405 | 2.214 | 10.362 | 0.027 | 2.15 | 107.639 | 0.000 |

The summary statistics shows that the average total aid to GDP from Turkey to TRNC is 8% of the GDP of TRNC in period 1983-2017. The total aid reached the maximum of 17.2% of the GDP of TRNC in 1984 while this ratio decreased its minimum level in 2016 to 4.4% of the GDP of TRNC. The GDP per capita of TRNC has regularly increased from 1.250 Dollars in 1983 to 14.421 Dollars in 2008. Between 2002 and 2008 the GDP of TRNC increased by more than 3 times its 2002 level. With the effect of 2008 Financial crisis, the increasing trend disappeared and the GDP per capita of TRNC in 2017 has occurred at less than its 2008 level as 11.523 Dollars.

The share of government expenditure in GDP has followed an increasing trend in Turkey. While government expenditures constitute only 7.5% of Turkey's GDP, in 2009 this share increased to 15.7 % of the Turkey's GDP. The inflation of TRNC has been unstable in the relevant period. The inflation rate has reached its peak value in 1994 as annual 215 %. However, it started to decrease since then and in 2005 inflation rate has reached to its lowest level of 2.7 %.

The normality test results are also given in Table 4-1. For GDP/POP and GOV/GDP the p-value of Jarque-Bera statistics is greater than 5% significance level. On the other hand, for both AID/GDP and inflation rate it is less than 5%. These results show that only for GDP/POP and GOV/GDP the null hypothesis of normal distribution should not be rejected.

While GDP/POP and GOV/GDP ratio are normally distributed, inflation and AID/GDP ratio are not normally distributed in the relevant period. In the following part of the study empirical methodology is examined.

This paper aims to investigate whether the alignment of ideologies among ruling governments of TRNC and Turkey is a significant factor on the amount of aid given by Turkey to TRNC. Several factors' effects are controlled in studying this relationship. The equation of the model of thesis is constituted as below,

$$\frac{Aid_t}{GDP_t} = \beta_0 + \beta_1 \frac{GDP_t}{POP_t} + \beta_2 \frac{Gov_t}{GDP_t} + \beta_3 Inflation + \beta_4 Crisis + \beta_5 Parties + e_t$$

Where;

Aid/GDP: Total aid from Turkey to TRNC as a share of TRNC's GDP.

GDP/POP: GDP per capita of TRNC (in current US dollars)

Gov/GDP: Turkey's government spending as a share of GDP.

Inflation: Inflation rate of TRNC.

Crisis: This dummy variable takes 1 if there is a major financial crisis, 0 otherwise.

Parties: This dummy variable takes 1 if the ruling political party ideologies are similar in both Turkey and TRNC, 0 otherwise.

The formation of the Parties dummy variable is as follows. Firstly, for each year the ruling party (or coalition) is categorized as left-wing or right wing based on the ideology of ruling party starting that year. Parties in power for both countries are categorized as;

- Right wing if Government in which a right-wing party is in power alone.
- Right wing if Coalition government in which the right-wing party is the major partner.
- Left wing if Government in which a left-wing party is in power alone.
- Left wing if Coalition government in which the left-wing party is the major partner.

As a result of this categorization, the dummy variable takes the value of “1” if both of the ruling parties are left wing or right wing, and 0 if one of the ruling parties is left (right) wing and the other is right (left) wing.

The effect of years of economic crisis is used as control variable. This variable takes the value of 1 for years including 1994, 1995, 2000, 2001, 2008, and 2009, 0 otherwise.

Although controlling several factors' effect helps to reach more reliable results about the relationship between the political alignment of ruling parties and aid from Turkey to TRNC, there are also some other issues which should be tested before the determination of the model and the interpretation of the results of the model. The first issue arises when time series data is used. One of the most critical problem is that, non-stationary variables might threaten the reliability of the results when the usage of time series data is in question.

The ARDL model to investigate the relationship between variables can be described as follows;

$$Y_t = \beta_0 + \beta_1 * t + \sum_{i=1}^m \phi_i * Y_{t-i} + \sum_{i=0}^n \alpha_i * X_{t-i} + u_t$$

In this equation, m and n refer the appropriate lag length of the variables. However, Pesaran and Shin (1999) points out that prior to the model the true ARDL (m, n) is rarely known. Therefore, he suggests using either AIC (Akaike Information Criteria) or SC (Schwarz Bayesian Criteria) to select appropriate m and n. On the other hand, the simulations performed by Pesaran et al. (2001) shows that the estimators of ARDL based on AIC and the estimators of ARDL based on SC have very similar small-sample performances, with the ARDL suggested by SC performing slightly better in the majority of the simulations.

As a matter of fact, Lütkepohl (1991) also compares SC and AIC in terms of their consistency and concludes that the SC is a consistent model selection criterion, while the AIC is not. Therefore, in this study SC is used as model selection criteria. However, the selection of lags of variables based on information criteria is not enough to determine the appropriate ARDL model. Wooldridge (2006) shows that if error terms of the model including lags of dependent variable follow an AR (Autoregressive) (1) model, then the estimators of the model become inconsistent. Therefore, the appropriate lag length should be selected only after ensuring that there is no serial correlation between the error terms.

After determining the model based on serial correlation test and information criterion, Bounds Test (which is developed by Pesaran et al. (2001)) is applied to check whether there is long-run relationship between the variables. If the F statistics of the Bounds Test is less than the corresponding critical value, it can be concluded that the series are not cointegrated. That is to say, Bounds Test suggests a cointegrated, long run relationship between variables only if the F-statistics of Bounds Test is greater than the corresponding critical values.

One of the advantages of the ARDL model is that it also allows to observe short-run relationship between the variables. By reparametrizing the ARDL(m,n) model, the error correction model can be generated. The reparameterization of ARDL model does also allow to examine the short run relationship between variables. The error correction model which can be obtained after reparameterization of ARDL model is given below:

$$\Delta Y_t = \alpha_0 + \alpha_1 ECT_{t-1} + \sum_{i=1}^p \alpha_2 \Delta Y_{t-i} + \sum_{i=0}^q \alpha_3 \Delta X_{t-i} + u_t$$

Error Correction Term: $ECT_{t-1} = Y_{t-1} - \beta_1 - \beta_2 * X_{t-1}$

The ECT_{t-1} which is a one-period lagged value of the error term is obtained in the previous

equation. This delayed value is defined as the error correction term. Kripfganz and Schneider (2018) state that there is a long-run relationship between the variables if the coefficient of error correction term, α_1 , is between -1 and 0. On the other hand, Narayan (2006) suggests that even if the error correction term is between -1 and -2, the long-run cointegrating relationship exists but in a different manner. He states that;

“If the error correction term is between -1 and -2, instead of monotonically converging to the equilibrium path directly, the error correction process fluctuates around the long-run value in a dampening manner. However, once this process is complete, convergence to the equilibrium path is rapid” (Narayan, 2006: 339).

Based on this methodology, the ARDL model, its corresponding Error Correction Model and the long-run coefficients can be illustrated as in the following equations;

$$AidtoGDP_t = \beta_0 + \sum_{i=1}^m \phi_i * AidtoGDP_{t-i} + \sum_{i=0}^n \alpha_{i+1} * Parties_{t-i} + \sum_{i=0}^q \delta_{i+1} * GDPperCa_{t-i} + \sum_{i=0}^r \gamma_{i+1} * GovExpencerCa_{t-i} + \sum_{i=0}^s \rho_{i+1} * Inflation_{t-i} + \sum_{i=0}^s \theta_{i+1} * Crisis_{t-i} + u_t$$

Error Correction Model

$$\Delta AidtoGDP_t = \beta_0 + \sum_{i=1}^{m-1} \phi_i * \Delta AidtoGDP_{t-i} + \sum_{i=0}^{n-1} \alpha_{i+1} * \Delta Parties_{t-i} + \sum_{i=0}^{q-1} \delta_{i+1} * \Delta GDPperCa_{t-i} + \sum_{i=0}^{r-1} \mu_{i+1} * \Delta GovExpCa_{t-i} + \sum_{i=0}^s \rho_{i+1} * \Delta Inf_{t-i} + \sum_{i=0}^s \theta_{i+1} * \Delta Crisis_{t-i} + \gamma * ECT + \varepsilon_t$$

Where;

- γ is the error correction coefficient,
- ECT is the error correction term which is generated depending on the long-run equation.

The long run equation can be shown as;

*Long Run Coefficients**Error Correction Term*

$$= \text{AidtoGDP}_{t-1} - \theta_0 - \theta_1 * \text{Parties}_{t-1} - \theta_2 * \text{GDPperCa}_{t-1} - \theta_3 * \text{GovExpCa}_{t-1} + \theta_4 * \text{Inflation}_{t-1} + \theta_5 * \text{Crisis}$$

Based on these equations, the Bounds Test which has the following null and alternative hypothesis should be run.

$$H_0: \theta_1 = \theta_2 = \theta_3 = \theta_4 = \theta_5 = 0$$

H_0 : At least one of the coefficients does not equal to zero

If the null hypothesis of no cointegrated relationship between variables is not rejected, it is concluded the variables does not have long run relationship.

4. EMPIRICAL RESULTS**4.1. Unit Root Test Results**

In this study, Philips-Perron test is used for testing the stationarity of variables. Table 4 demonstrates t-statistics and their significance level which are obtained as a result of Philips-Perron test.

Table 1: Philips Perron Test Results

| Variables | Form | None | With Constant | Trend |
|-----------|-------------------|-----------|---------------|-----------|
| AID/GDP | Level | -1.236 | -3.036** | -5.930*** |
| | First Differenced | | | |
| GDP/POP | Level | 0.648 | -0.869 | -1.822 |
| | First Differenced | -4.336*** | -4.579*** | -4.523*** |
| INFLATION | Level | -2.083** | -3.126** | -4.291*** |
| | First Differenced | | | |
| GOV/GDP | Level | 0.660 | -1.270 | -2.736 |
| | First Differenced | -5.794*** | -5.935*** | -5.852*** |

Notes: Table 2 demonstrates t- values for each variable which obtained as a result of Philips-Perron test.
* represents the 10% level of significance,
** represents the 5% level of significance and
*** represents the 1% level of significance.

Table 2 indicates that AID/GDP is stationary at least %5 level of significance since p-value of t-statistics of both PP test with constant and PP test with trend are less than at least 5%. In this situation, the null hypothesis of variable is non-stationary is rejected. Similarly, inflation is also a stationary variable because all of the three types of

PP unit root tests suggest that inflation is stationary at least at 5% significance level. On the other hand, when PP test is applied to GDP/POP and GOV/GDP variables at their level form, they are found to be non-stationary since p-value of t-statistics of PP tests are greater than even 10% significance level. In other words, the null

hypothesis (variables are non-stationary) cannot be rejected. In this manner, PP test is applied to their first difference form. Results of PP tests suggest that GDP/POP and GOV/GDP variables become stationary at first difference.

Eventually, as can be clearly understood from the Table 2, AID/GDP and Inflation variables are I(0) while GDP/POP and GOV/GDP variables are I(1) which means that the stationarity levels of variables are suitable for the ARDL approach.

5.2. Determination of Maximum Lag Length

Brooks (2008), suggests that the max lag should be chosen based on information criteria. In this study AIC and SC criteria are used.

Table 2: Maximum Lag Selection

| P | SC | AIC | LM |
|---|---------|---------|--------|
| 1 | -4.577 | -4.891 | 0.751 |
| 2 | -4.577 | -4.891 | 0.751 |
| 3 | -4.577 | -4.891 | 0.751 |
| 4 | -5.995* | -7.059* | 0.219* |

Notes: The p-value of Breusch Godfrey LM serial correlation test is reported for each lag length.

The results show that max lag should be chosen as 4 because at lag 4, the lowest value of information criteria are obtained and LM test results suggest that when 4 lags are included, the

model does not involve autocorrelation, because p-value of LM test statistics is 0.219 which is greater than even 10% significance level.

5.3. Selecting the Appropriate ARDL Model

Table 3: Model Selection

| AIC | BIC | HQ | Specification |
|-----------|-----------|-----------|------------------------|
| -7.059744 | -5.995818 | -6.712930 | ARDL(1, 3, 4, 1, 4, 4) |
| -7.145018 | -5.988577 | -6.768047 | ARDL(3, 4, 4, 2, 2, 4) |
| -7.122276 | -5.965834 | -6.745305 | ARDL(3, 3, 4, 1, 4, 4) |
| -7.151636 | -5.948937 | -6.759586 | ARDL(3, 4, 4, 2, 3, 4) |
| -7.195242 | -5.946285 | -6.788113 | ARDL(4, 4, 4, 2, 3, 4) |
| -7.134106 | -5.931407 | -6.742056 | ARDL(4, 4, 4, 2, 2, 4) |
| -7.010187 | -5.900003 | -6.648295 | ARDL(2, 3, 4, 1, 4, 4) |
| -7.142909 | -5.893953 | -6.735781 | ARDL(3, 4, 4, 2, 4, 4) |
| -7.095452 | -5.892753 | -6.703402 | ARDL(3, 4, 4, 3, 2, 4) |
| -7.136769 | -5.887813 | -6.729641 | ARDL(3, 3, 4, 3, 4, 4) |

After choosing max lag for the ARDL model, as a second step, the appropriate lag for each

variable of the ARDL model is also determined by information criteria. As explained in the

methodology part, in this study SC is used to decide appropriate ARDL model. Table 4 reports the models which have the lowest SC. According to the

results, ARDL (1,3,4,1,4,4) should be chosen because the test statistics (-5.99) is the lowest.

5.4. Testing Long Run Cointegration Relationship

5.4.1. Bounds Test

Table 4: Bounds Test Result

| Test Statistic | Value | Significance Level | I(0) | I(1) |
|--|--------|--------------------|-------|-------|
| F-statistics | 12.913 | 10% | 2.578 | 3.858 |
| | | 5% | 3.125 | 4.608 |
| | | 1% | 4.537 | 6.370 |
| Notes: The critical values are corresponding to the finite sample (n=30) and they are obtained from Pesaran et al. (2001:300) Table CI (iii). | | | | |

After the lag length of the model was determined, bounds test was applied to control the existence of a cointegration relationship between the examined variables. As Table 5 demonstrates, the F-statistic value (12.913) is quite higher than the upper bound critical value (4.608) at 5% level of significance.

In this case, the null hypothesis of no co-integrating relationship between variables is

rejected. Additionally, the result of Bounds test indicates that there is a long-run relationship between the variables in the event that AID/GDP is dependent variable. After all, since the presence of a cointegration relationship among the variables is detected, the ARDL model can be established in order to find out long-run and short-run relationships.

5.5. Diagnostic Tests

Table 5: Diagnostic Test Results

| | Test Name | Test Statistics | P-Value |
|---|-----------------------|-----------------|---------|
| Serial Correlation | Breusch-Godfrey LM | 2.307 | 0.219 |
| Heteroskedasticity | Breusch-Pagan-Godfrey | 2.520 | 0.090 |
| Normality | Jarque Bera | 1.097 | 0.577 |
| Misspecification | Ramsey Reset | 3.553 | 0.101 |
| Notes: F-statistics results used in Breusch-Godfrey LM test, Breusch-Pagan-Godfrey test and Ramsey Reset test. | | | |

Before interpreting the long-term coefficients of the model and producing the error correction model, Diagnostic Tests should be

carried out to ensure that the model is free from problems including serial correlation, heteroskedasticity, Normality, stability and

misspecification. Corresponding tests for each problem are performed. Only after passing through these tests, the estimated equations will be considered valid and meaningful.

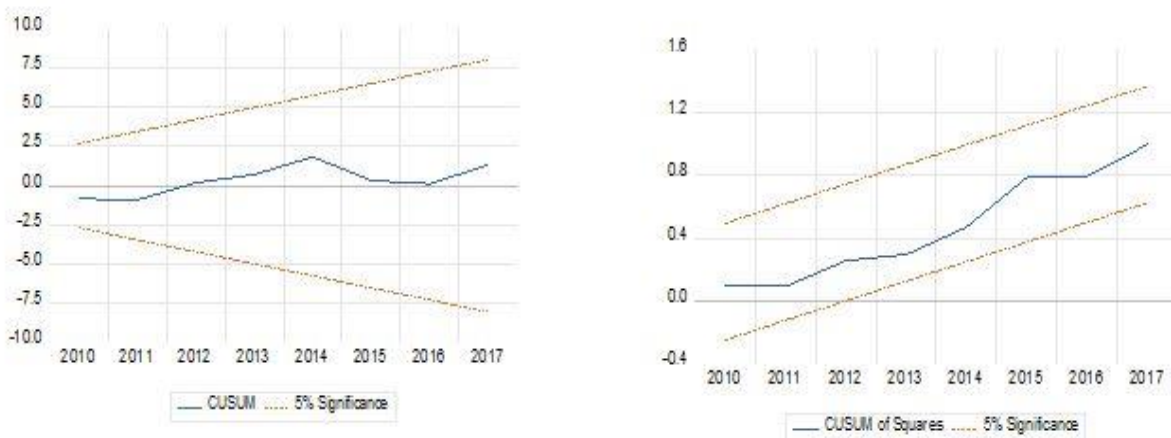
As Table 6 shows, firstly, Breusch-Godfrey test is used to test the existence of autocorrelation in the model. The prob value (0.219) is greater than all conventional levels of significance so the null hypothesis (no serial correlation) cannot be rejected.

Secondly, Breusch-Pagan-Godfrey test is used to test presence of heteroscedasticity in the model. As a result of Breusch-Pagan-Godfrey test, the prob value is calculated as 0.090, so the null

hypothesis (the error terms of the model have constant variance) cannot be rejected for 5% level of significance.

Thirdly, normality of the error terms is tested via Jarque Bera test. As Table 4-6 indicates, the prob value was found to be 0.577 as a result of Jarque Bera test. In this situation, the null hypothesis that residuals are normally distributed cannot be rejected. Lastly, the Ramsey Reset test is used to check the existence of misspecification error in the model. The null hypothesis of no specification error in the model cannot be rejected since the prob value (0.101) is greater than all conventional levels of significance.

Figure 1. CUSUM and CUSUMQ Tests



As Figure 1 shows, CUSUM and CUSUMQ (cumulative sum of squares) tests are performed in order to check the stability of the parameters and presence of structural break in the model. Since the CUSUM plot takes place in the 95% critical bound, therefore the null hypothesis of stability of parameters cannot be rejected. As a result of CUSUM and CUSUMQ tests, it can be said that the long-term relationship between variables is also

confirmed by these tests and also coefficients in the cointegrating vector are stable. Therefore, based on CUSUM and CUSUM Square results it is clearly seen that there is no structural break in the model for the relevant period. Overall, the diagnostic tests indicate that the estimated model has satisfied the required conditions.

5.6. The Short Run Determinants of ARDL Model

Table 6: Short Run Results

| Variables | Coefficients | t-stat | Prob |
|---|--------------|---------|-------|
| $\Delta GDP/POP$ | -0.000* | -1.913 | 0.092 |
| $\Delta GDP/POP t-1$ | 0.000*** | 9.299 | 0.000 |
| $\Delta GDP/POP t-2$ | 0.000*** | 5.984 | 0.000 |
| $\Delta GOV/GDP$ | -0.430** | -3.148 | 0.014 |
| $\Delta GOV/GDP t-1$ | 0.087 | 0.633 | 0.545 |
| $\Delta GOV/GDP t-2$ | 0.756*** | 5.405 | 0.001 |
| $\Delta GOV/GDP t-3$ | 1.086*** | 7.854 | 0.000 |
| ΔINF | -0.057*** | -10.841 | 0.000 |
| $\Delta PARTIES$ | 0.020*** | 5.165 | 0.001 |
| $\Delta PARTIES t-1$ | -0.066*** | -9.121 | 0.000 |
| $\Delta PARTIES t-2$ | -0.081*** | -10.472 | 0.000 |
| $\Delta PARTIES t-3$ | -0.051*** | -9.923 | 0.000 |
| $\Delta CRISIS$ | 0.036*** | 5.539 | 0.001 |
| $\Delta CRISIS t-1$ | -0.083*** | -10.464 | 0.000 |
| $\Delta CRISIS t-2$ | -0.018*** | -4.715 | 0.002 |
| $\Delta CRISIS t-3$ | -0.039*** | -9.122 | 0.000 |
| C | 0.078*** | 10.607 | 0.000 |
| $ECT t-1$ | -1.134*** | -11.220 | 0.000 |
| Model Statistics | | | |
| $R^2= 0.970$ | | | |
| $Adj- R^2= 0.930$ | | | |
| Notes: * represents the 10% level of significance, ** represents the 5% level of significance and | | | |

As can be observed from the Table 7, the error correction term (ECT) of short-run results is negative and significant at even 1% level. This suggests that there is a long run cointegrating relationship between the variables.

On the other hand, because the coefficient of the error correction term is less than -1 and greater than -2, as Narayan (2006) claims the long run cointegrating relationship does not converge monotonically to the equilibrium path directly. Instead, the error correction process fluctuates around the long-run equilibrium in a dampening manner.

ARDL approach allows observing not only the long-run but also the short-run relationship

among the variables. From short run results, it is seen that there is a negative and significant contemporaneous relationship between government expenditure as a share of GDP of Turkey and aid as a share of GDP in the short run. The correlation between inflation and aid as a share of GDP is also negative in the short run. The contemporary coefficient of the parties dummy variable turns out to be positive which suggests that even in the short run a positive and significant impact of ideology alignment of ruling parties on aid as a share of GDP exists. In terms of the relationship between economic crisis and aid as a share of GDP, the short run findings suggest that in the crisis years aid as a share of GDP increases significantly.

5.7. The Long Run Determinants of ARDL Model

Table 7: Long Run Coefficients

| Variables | Coefficients | t-stat | Prob |
|------------------|--------------|--------|-------|
| <i>GDP/POP</i> | -0.000*** | -3.436 | 0.009 |
| <i>GOV/GDP</i> | -0.130 | -0.664 | 0.525 |
| <i>INFLATION</i> | -0.080*** | -5.550 | 0.001 |
| <i>PARTIES</i> | 0.088*** | 5.424 | 0.001 |
| <i>CRISIS</i> | 0.091*** | 4.657 | 0.002 |

Notes: * represents the 10% level of significance,
 ** represents the 5% level of significance and
 *** represents the 1% level of significance.

The long run coefficients of ARDL model suggest that the alignment of the ideology of ruling parties is highly correlated with the aid as a share of GDP even after controlling GDP per capita, inflation, government expenditure as a share of GDP and economic crisis effect. The results also show that addition to the alignment of the ideology of ruling parties, inflation, years of crisis and GDP per capita are also other significant determinants of aid as a share of GDP.

Specifically, the findings suggest that aid as a share of GDP, when both of the wings of the ruling parties are same, is 8.8% higher than the aid as a share of GDP when either of the ruling parties is left-wing while the other is right-wing. This result confirms the suggestion of Stokke (1989), Lumsdaine (1993) and Thérien and Noël (2000) in terms of the fact that foreign aid is not independent from party politics. However, they suggest that leftist parties are more likely to be involved in more generous aid packets than rightist parties.

On the other hand, this study examines the effect of party ideology on aid as a share of GDP from another perspective. It concludes that it is not only the wing of the ideology but also the alignment of the ruling parties' ideology that matters on aid as a share of GDP. This positive

relationship can be explained by Dreher et. al (2015). They suggest that political misalignment between donor and recipient governments may cause transaction costs to increase and furthermore it will give rise to incentive problems and thereby decrease the amount of aid. Alesina and Dollar (2000), Dreher and Jensen (2007) are other studies that do also reach the same positive relationship between aid and political alignment of aid recipient and donor countries.

GDP per capita is another determinant of aid as a share of GDP. The results claim that as the GDP per capita of TRNC increases the aid as a share of GDP decreases significantly. \$1000 increase in GDP per capita decreases aid as a share of GDP by averagely 0.4%. Although this effect is statistically significant, it does not seem economically significant.

The results propose that Turkey's government expenditure as a share of GDP does not have a significant effect on aid as a share of GDP in the long run, because the p-value of the coefficient of Turkey's government expenditure as a share of GDP is 0.525 which is greater than even 10% significance level. On the other hand, inflation has significantly negatively correlated with the aid as a share of GDP. It is concluded that 1 percentage increase in inflation decreases aid as a share of GDP

by an average of 8 percentage point. Furthermore, the years of crisis does have positive and significant correlation with aid as a share of GDP. The findings claim that in the years of crisis the aid as a share of GDP is 9.1% higher than aid as a share of GDP in the non-crisis years.

CONCLUSION

Foreign aid is considered as an essential bonding tool in international relations and a means of development. On the other hand, the foreign aid between Turkey and TRNC may also be seen as a representation of historical and cultural solidarity. Therefore, foreign aid transfer from Turkey to TRNC is an important part of this multifaceted relationship. This study investigates whether the amount of Turkey's foreign aid to TRNC is affected by political alignment of ruling political parties of these countries. ARDL approach is used to examine the impact of cohesion between ruling parties on the foreign aid from Turkey to TRNC. The findings of the study suggest a long-run relationship between foreign aid and alignment of ruling parties of the two countries. It is concluded that the foreign aid when the ruling parties have a similar political ideology is significantly greater than the foreign aid when the ruling parties' political ideology does not coincide. This result is consistent even after controlling the GDP per capita of TRNC, inflation of TRNC, Turkey's government expenditure as a share of GDP and economic crisis effect. The results also claim that inflation, years of crisis, and GDP per capita of TRNC are other determinants of foreign aid to TRNC. While inflation and GDP per capita of TRNC are negatively correlated with the foreign aid to TRNC from Turkey, it is concluded that the foreign aid to TRNC is greater in the years of economic crisis.

The findings of this study do have some political implications. According to the results, it turns out that the foreign aid from Turkey to TRNC depends on the fact whether the ruling parties of these two countries have similar political views. However, when the critical importance of foreign

aid in the TRNC economy is taken into account, it is highly concerning for TRNC to depend on such a fragile source of finance. The findings suggest that any mismatch between political views of ruling parties, causes a decrease in amount of foreign aid from Turkey to TRNC. Therefore, with the arrangements to be made, it is very important for the TRNC economy that foreign aid from Turkey is not affected by political views of the ruling parties of both countries. Otherwise, the fluctuation in foreign aid that will arise according to the views of political parties may create heavy economic pressure on the TRNC economy. If this situation cannot be resolved, the necessity of TRNC to take measures for reducing his dependence on foreign aid, is another policy implication that can be drawn from the results of this study.

This study does also have some limitations one of the which is that the foreign aid data is not available after 2017. Any possible effect on the relationship between foreign aid and political alignment of ruling parties that might arise in this period cannot be covered by this study.

In this study, it has been investigated whether the political views of the ruling parties have an effect on the amount of foreign aid from Turkey to the TRNC. On the other hand, the issue of how effectively the TRNC uses the foreign aid sent by Turkey can be another important research topic. In this context, whether the effective use of foreign aid sent to the TRNC varies according to the political views of the ruling parties, is one of the subjects to be studied in the future. Secondly, whether the Economic Programs determined within the framework of the Economic and Financial Cooperation Protocol (which was put into practice in 2001) have a significant effect on the effective use of foreign aid is another issue that can be examined in future research.

ARAŞTIRMACILARIN KATKI ORANI BEYANI VE ÇIKAR ÇATIŞMASI BİLDİRİMİ

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