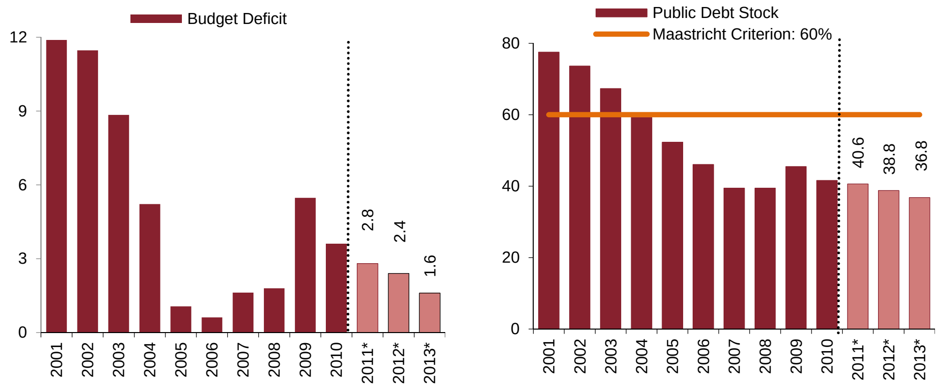
# 6. Public Finance

The faster-than-expected economic recovery and falling interest expenditures helped enhance Turkey's fiscal outlook (Chart 6.1). Furthermore, the budget performance continues to improve as of the first quarter of 2011. The increased tax revenues amid robust domestic demand and the decline in interest expenditures were the major drivers of the improved budget balances in this period. In addition, the relative slowdown in the growth of primary expenditures also contributed to the improvement in budget balance.

**Chart 6.1.**
Central Government Budget Balance and EU-Defined Public Debt Stock
(Percent of GDP)




* MTP (2011-2013) targets.
Source: Ministry of Finance.

Fiscal targets available in the October 2010 MTP for 2011-2013 hint at a gradual decline in the ratio of public expenditures to GDP. Therefore, the medium-term forecasts in the last chapter of this Report are based on an outlook where fiscal policy would be gradually tightened and public expenditures would make an increasingly smaller contribution to domestic demand. Hence, the public sector is expected to exert no significant pressure on inflation in the medium term. However, in order to maintain fiscal discipline and ensure that Turkey continues to have more positive readings than other emerging economies, strengthening the fiscal structure by implementing the institutional and structural reforms envisaged in the MTP remains critical.

## 6.1. Budget Developments

The central government budget produced a deficit of TL 4.1 billion in the first quarter of 2011, while the primary balance delivered a surplus of TL 9.8 billion (Table 6.1.1). Higher tax revenues fueled by economic recovery and falling interest expenditures were the main drivers of the year-on-year improvement in the budget balance. In addition, the relative slowdown in the growth of primary expenditures helped bring the budget deficit down.

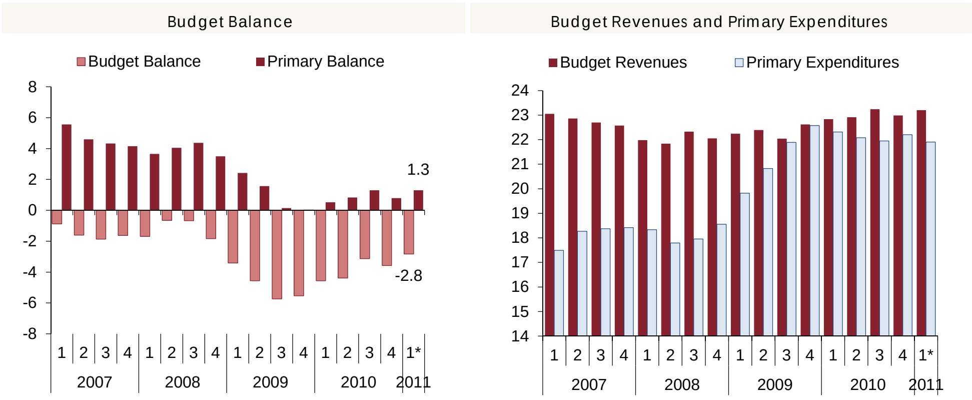
**Table 6.1.1.**
Central Government Budget Aggregates
(Billion TL)

| | January-March 2010 | January-March 2011 | Rate of Increase (Percent) | Actual/Target (Percent) |
|---|---|---|---|---|
| Central Government Expenditures | 68.4 | 72.9 | 6.6 | 23.3 |
| Interest Expenditures | 15.0 | 14.0 | -6.9 | 29.4 |
| Primary Expenditures | 53.4 | 58.9 | 10.3 | 22.2 |
| Central Government Revenues | 57.0 | 68.7 | 20.5 | 24.6 |
| I. Tax Revenues | 47.9 | 57.5 | 19.9 | 24.7 |
| II. Non-Tax Revenues | 6.8 | 8.7 | 27.7 | 22.1 |
| **Budget Balance** | **-11.3** | **-4.1** | - | - |
| **Primary Balance** | **3.7** | **9.8** | - | **70.5** |

Source: Ministry of Finance.

Having improved since the first quarter of 2010, central government budget balance and primary budget balance to GDP ratios deteriorated slightly amid the rapid increase in primary expenditures during the fourth quarter. On the other hand, the first quarter's favorable budget outturn helped improve both ratios (Chart 6.1.1). The steady upward trend in the budget revenues to GDP ratio since the fourth quarter of 2009, driven by higher tax revenues, resumed in the first quarter of 2011 after the pause in the last quarter of 2010. Meanwhile, notwithstanding the slight slowdown during the first three quarters of 2010, the primary expenditures to GDP ratio increased in the last quarter before falling back in the first quarter of 2011 (Chart 6.1.1).

**Chart 6.1.1.**
Central Government Budget
(Annualized, Percent of GDP)




* Estimate.
Source: Ministry of Finance.

Central government primary expenditures increased slightly by 10.3 percent year-on-year in the first quarter of 2011. The slight increase in primary expenditures was mainly due to the 6.6 percent increase in current transfers, the major component of primary expenditures. Personnel expenditures, another major component of primary expenditures, were up 15.7 percent, while purchase of goods and services decreased by 3.3 percent. Meanwhile, capital expenditures increased by about 48.2 percent, implying that public investments made a positive contribution to GDP growth in the first quarter of 2011 (Table 6.1.2).

**Table 6.1.2.**
Central Government Primary Expenditures
(Billion TL)

| | January-March 2010 | January-March 2011 | Rate of Increase (Percent) | Actual/Target (Percent) |
|---|---|---|---|---|
| **Primary Expenditures** | **53.4** | **58.9** | **10.3** | **22.2** |
| 1. Personnel Expenditures | 16.2 | 18.8 | 15.7 | 26.0 |
| 2. Government Premiums to SSA | 2.8 | 3.3 | 20.1 | 26.0 |
| 3. Purchase of Goods and Services | 4.2 | 4.8 | 13.6 | 15.9 |
| a) Defense and Security | 1.1 | 1.2 | 15.6 | 12.2 |
| b) Health Expenditures | 1.1 | 1.1 | -2.8 | 22.1 |
| 4. Current Transfers | 27.7 | 29.6 | 6.6 | 25.5 |
| a) Duty Losses | 1.0 | 0.4 | -61.6 | 7.4 |
| b) Health, Pension and Social Benefits | 14.8 | 15.7 | 6.4 | 25.2 |
| c) Agricultural Support | 3.2 | 2.8 | -11.3 | 46.8 |
| d) Shares Reserved from Revenues | 6.6 | 7.6 | 15.0 | 26.4 |
| 5. Capital Expenditures | 1.0 | 1.5 | 48.2 | 6.9 |
| 6. Capital Transfers | 0.3 | 0.3 | -5.6 | 6.2 |

Source: Ministry of Finance.

General budget revenues increased by 20.9 percent year-on-year in the first quarter of 2011. Tax revenues were up 19.9 percent and non-tax revenues increased by 27.7 percent on soaring capital revenues (Table 6.1.3). In particular, the substantial increase in consumption based tax revenues such as domestic VAT and VAT on imports indicates that consumption demand remains strong. Additionally, the record high temporary corporate tax payments also contributed to the rapid increase in tax revenues. SCT revenues increased at a relatively slower pace owing to lower SCT payments on tobacco products and the limited increase in SCT on oil and natural gas products.

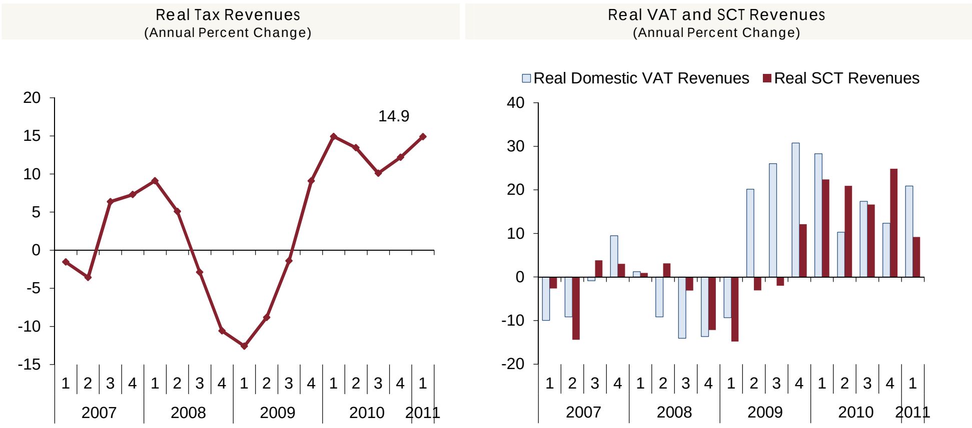
**Table 6.1.3.**
Central Government General Budget Revenues
(Billion TL)

| | January-March 2010 | January-March 2011 | Rate of Increase (Percent) | Actual/Target (Pecent) |
|---|---|---|---|---|
| **General Budget Revenues** | **54.7** | **66.2** | **20.9** | **24.4** |
| **I-Tax Revenues** | **47.9** | **57.5** | **19.9** | **24.7** |
| Income Tax | 9.6 | 10.4 | 8.6 | 22.0 |
| Corporate Tax | 4.6 | 6.6 | 41.7 | 28.3 |
| Domestic VAT | 5.8 | 7.3 | 26.3 | 27.4 |
| SCT | 11.7 | 13.3 | 14.0 | 21.8 |
| VAT on Imports | 7.7 | 10.3 | 34.1 | 25.1 |
| **II-Non-Tax Revenues** | **6.8** | **8.7** | **27.7** | **22.1** |
| Enterprise and Property Revenues | 1.7 | 2.6 | 57.1 | 36.0 |
| Interests, Shares and Fines | 4.6 | 4.3 | -6.8 | 20.6 |
| Capital Revenues | 0.1 | 1.3 | - | 13.0 |

Source: Ministry of Finance.

The contraction in real tax revenues since the third quarter of 2008 has been replaced by a significant growth as of the fourth quarter of 2009 with the recovery of private consumption demand. After a robust first quarter, the annual rate of increase in real tax revenues slowed down slightly on waning base effects in the consecutive two quarters before rising again in the last quarter of 2010 (Chart 6.1.2). Real tax revenues increased by 14.9 percent year-on-year in the first quarter of 2011. SCT and domestic VAT revenues, major components of tax revenues, increased by 9.2 and 20.9 percent year-on-year, respectively, in real terms (Chart 6.1.2).

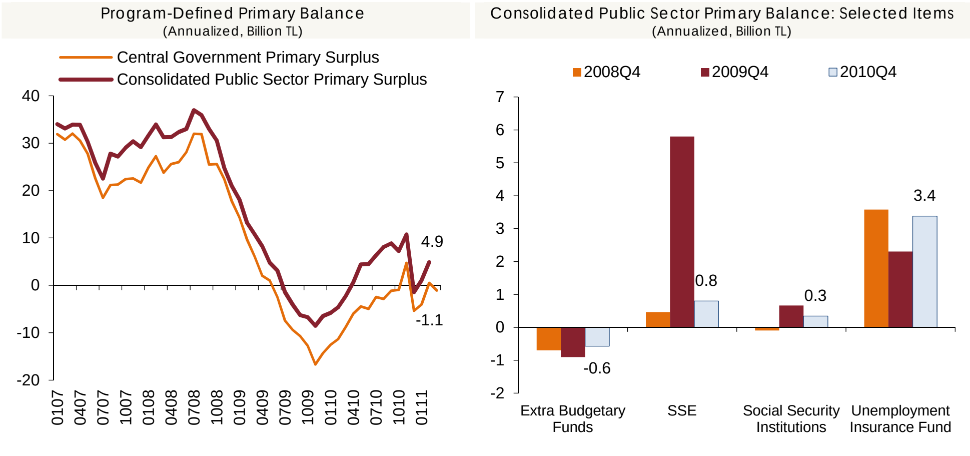
**Chart 6.1.2.**
Real Tax Revenues
(Percent of GDP)




Source: Ministry of Finance.

The program-defined consolidated public sector and the central government primary balance have improved throughout the last quarter of 2009 and the first three quarters of 2010, but deteriorated significantly in the last quarter of 2010 due to the rapid increase in primary expenditures. With the favorable fiscal performance in the first quarter of 2011, the program-defined primary balance started to improve again (Chart 6.1.3). Meanwhile, primary balances of extrabudgetary funds and the Unemployment Insurance Fund improved year-on-year during the last quarter of 2010, whereas primary balances of SEE and social security institutions deteriorated (Chart 6.1.3).

**Chart 6.1.3.**
Primary Balance




Source: Treasury.

## 6.2. Developments in the Debt Stock

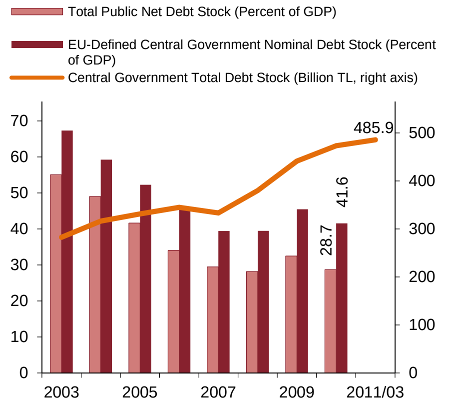
The fiscal and debt management policies consistent with the prudent monetary policy stance in 2010 as well as the faster-than-expected economic recovery since the last quarter of 2009 helped improve fiscal balances, thus public debt stock indicators. 2010 was marked by a decline in public debt ratios, a significant fall in the real cost of borrowing, an extended average maturity of debt, a decreased share of interest rate and exchange rate-sensitive debt in overall debt and a reduced domestic debt rollover ratio. This favorable outlook also continued into the first quarter of 2011.

The central government debt stock increased by 2.6 percent from end-2010 to TL 485.9 billion at end-March 2011. Changes in net domestic debt and net external debt accounted for TL 7.1 billion and TL 3.0 billion, respectively, of the increase in central government debt. Meanwhile, with the depreciation of the USD against the euro, parity changes brought central government debt up by TL 2.4 billion (Chart 6.2.1).

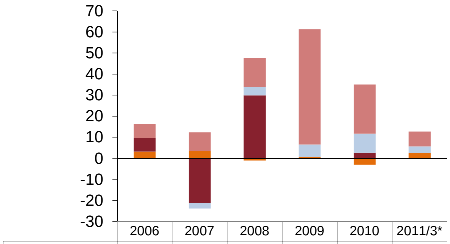
Public debt ratios, which increased in 2009 on low primary surplus performance and economic contraction, declined in 2010 as the above factors have reversed. The ratios of total net public debt stock and EU-defined general government nominal debt stock to GDP declined by 3.8 and 3.9 percentage points from end-2009 to 28.7 and 41.6 percent, respectively (Chart 6.2.1).

**Chart 6.2.1.**
Public Debt Stock Indicators

Public Debt Stock Indicators




Analysis of the Changes in Central Government Debt Stock (Billion TL)



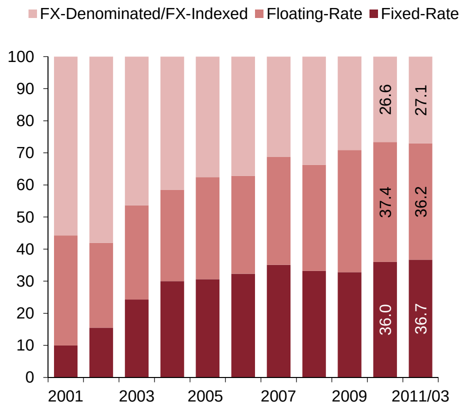
| | 2006 | 2007 | 2008 | 2009 | 2010 | 2011/3* |
|---|---|---|---|---|---|---|
| Net Domestic Borrowing | 6.7 | 8.9 | 13.9 | 54.8 | 23.3 | 7.1 |
| Net External Borrowing** | -0.5 | -2.6 | 4.0 | 5.9 | 9.0 | 3.0 |
| Exchange Rate Effect*** | 6.4 | -21.2 | 29.9 | -0.1 | 2.6 | 0.2 |
| Parity Effect**** | 3.2 | 3.4 | -1.0 | 0.6 | -3.1 | 2.4 |

* Changes compared to end-2010.
** Changes in net debt denote changes adjusted for exchange rate and parity effect.
*** Changes from fluctuations in TL/USD.
**** Changes from fluctuations in USD/EUR and USD/SDR.
Source: Treasury, CBRT.

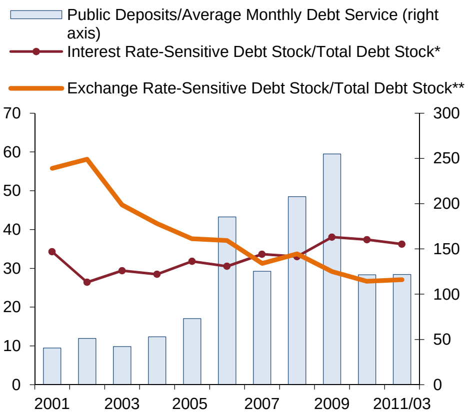
The Treasury's financing program for 2011 has been formulated based on an approach to limit the liquidity, interest and foreign exchange sensitivity of the debt stock. In this regard, the increase in the share of fixed-rate instruments has continued into March 2011 (Chart 6.2.2).

**Chart 6.2.2.**
Structure of the Central Government Debt Stock

Composition of the Central Government Debt Stock (Percent)



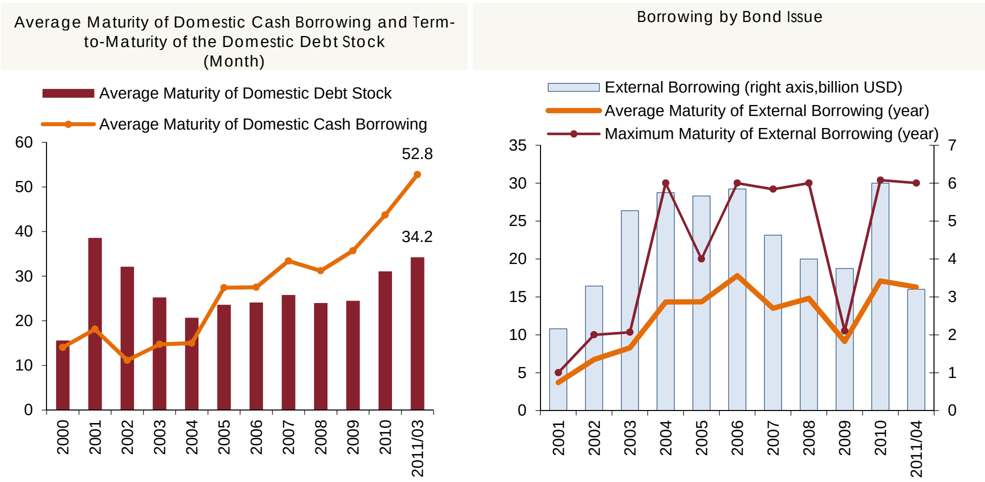

Vulnerability Indicators of the Central Government Debt Stock (Percent)




* Debt stock sensitive to interest rate includes discounted securities with a maturity less than 1-year and government securities with floating rates.
** Debt stock sensitive to exchange rate includes external debt stock, FX-denominated and FX-indexed domestic debt stock.
Source: Treasury, CBRT.

The financing strategy implemented to reduce liquidity risk also continues in 2011. The ratio of public deposits to average monthly debt service has been 121.8 percent as of the first quarter of 2011 (Chart 6.2.2). Amid the significantly increased average maturity of domestic cash borrowing, term-to-maturity of total domestic debt stock increased to 34.2 months in March 2011 (Chart 6.2.3). Moreover, bond issues have yielded a long-term external debt of USD 3.2 billion in the first four months of 2011, with an average maturity slightly down to 16.3 years from 2010 (Chart 6.2.3).

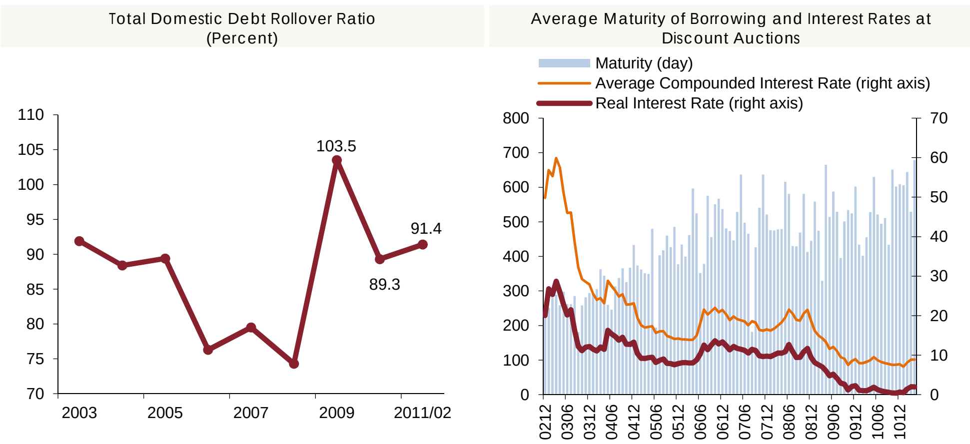
**Chart 6.2.3.**
Maturity of Borrowing from Domestic and External Markets




Source: Treasury, CBRT.

Having fallen rapidly since early 2009, the monthly average real interest rates at discount Treasury bill auctions remain low despite the slight increases in February, March and April 2011 (Chart 6.2.4). The substantially extended average maturity and the low cost of domestic borrowing support the favorable outlook for public debt sustainability.

**Chart 6.2.4.**
Domestic Borrowing




Source: Treasury, CBRT.

Domestic debt rollover ratio was 91.4 percent for January-February 2011 and is expected to decline to 85.7 percent in the first half of 2011 as envisaged by the Treasury's domestic borrowing strategy for April-June 2011 (Chart 6.2.4).