Box 6.1

Fiscal Policy Stance within the Framework of the New Economy Program

The New Economy Program (NEP) covering the 2019-2021 period was announced to the public on 20 September 2018. The main objective of the NEP is to restore price stability and financial stability in the short term, to ensure balancing in the economy and budgetary discipline, and to achieve economic change towards sustainable growth and equitable distribution in the medium term. On the fiscal side, it is stated that fiscal discipline will be the main supporter of the macro-balancing process. Under a tight fiscal policy, it is envisaged that budget expenditures will be reduced and budget revenues will be increased. This combination is expected to achieve a budget deficit to GDP ratio below 2 percent for the next three years and a gradual increase in the ratio of primary surplus to GDP to 1.3 percent at the end of the period (Table 1).

Under a tight fiscal policy, it is expected that the ratio of primary expenditures to GDP will be reduced by approximately one percentage point from 19.9 percent in 2018 to 19 percent in 2019 and to 18.5 percent in 2021 as this trend will continue during the NEP period (Table 1, Chart 1). In the same period, the increasing borrowing needs of the Treasury as well as interest rates and developments in exchange rates are envisaged to lead to a one percentage point increase in the ratio of interest payments to GDP from 2 percent in 2018 to 3 percent in 2021. On the other hand, it is observed that tax revenues, another important fiscal policy instrument, will exhibit an upward trend across the NEP period. Thus, it is expected that the tax revenues to GDP ratio will be 16.9 percent in 2018 and will increase gradually to 17 percent and 17.5 percent in 2019 and 2021, respectively. In sum, fiscal policy is expected to contribute to the macro-balancing process through a shrinking public economy.

Table 1: Central Government Budget (Percent of GDP)

	2017	2018[(1)]	2019[(2)]	2020[(2)]	2021[(2)]
Expenditures	**21.8**	**22.0**	**21.6**	**21.6**	**21.4**
Primary Expenditures	20.0	19.9	19.0	18.7	18.5
Interest Payments	1.8	2.0	2.6	2.9	3.0
Revenues	**20.3**	**20.0**	**19.8**	**19.7**	**19.7**
Tax Revenues	17.3	16.9	17.0	17.2	17.5
Non-Tax Revenues	3.0	3.2	2.8	2.5	2.3
Budget Balance	**-1.5**	**-1.9**	**-1.8**	**-1.9**	**-1.7**
Primary Budget Balance	**0.3**	**0.1**	**0.8**	**1.0**	**1.3**
EU-Defined Debt Stock	**28.3**	**31.1**	**28.5**	**28.2**	**27.2**

Source: NEP (2019-2021).
(1) Realization estimation.
(2) Program.

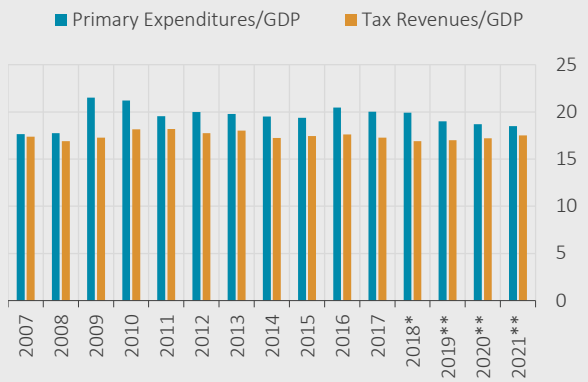
The fact that the most important component of fiscal consolidation is based on the savings to be obtained from public expenditures rather than tax increases displays a positive outlook in terms of contribution to price stability. As a matter of fact, it is stated that 60 billion Turkish lira of the total savings of 76 billion Turkish lira planned in 2019 will consist of spending cuts and 16 billion

Turkish lira will be composed of measures to increase public revenues. It is planned to make savings from publicinvestments, considered to be a highly flexible expenditure item, and to cut down on current transfer and consumption expenditures to the extent allowed by budgetary rigidities.

It is critical to take the cyclically-adjusted primary budget balance into account in the evaluation of the fiscal stance. The fact that tax revenues prove high (low) due to the effect of automatic stabilizers in periods of strong (weak) economic activity, makes it difficult to interpret the fiscal policy stance implied by the primary budget balance. In this respect, it is considered that the cyclically-adjusted primary budget balance, obtained by the elimination of parts of the tax revenues sensitive to business cycles, will be a healthier approach in reflecting the discretionary fiscal policy implementations.[1] Chart 2 shows that the cyclically-adjusted primary budget balance, which has trended downwards since 2013, declined sharply as a result of the expansionary fiscal policies put into effect in 2017. It is projected that the difference between the primary budget balance and the cyclically-adjusted primary budget balance will be closed in 2018 with the output gap nearing zero, whereas the difference between the two definitions is expected to widen in 2019 with the output gap in the negative territory along with a tight discretionary fiscal policy in effect. Accordingly, it is considered that the fiscal policy tightening implied by the cyclically-adjusted budget balance will be approximately 0.4 percentage points higher than the fiscal tightening implied by the primary budget balance (Chart 2). It is envisaged that the tight monetary and fiscal policy mix aimed at ensuring price stability will boost the effectiveness of monetary policy by contributing to the decline in the risk premium.

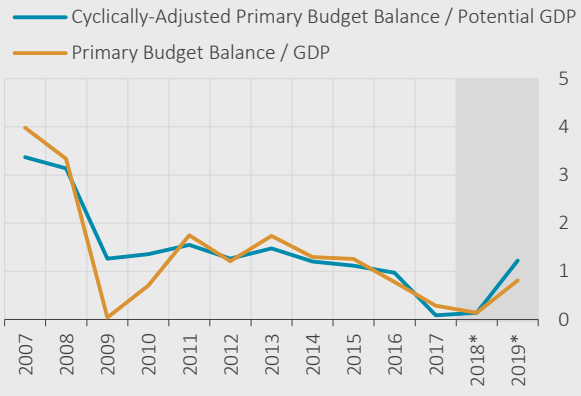
The macro-balancing process is based on a policy framework in which the rise in the debt stock caused by the relative increase in interest and exchange rates along with a moderate real growth rate would be balanced by tight monetary policy and fiscal discipline. In addition, during this period, fiscal policy is envisaged to support monetary policy through a gradual decline in the ratio of debt stock to GDP (Table 1). It is, nevertheless, important to note that the maintenance of the contribution of fiscal policy to the fight against inflation through adjustments in administered prices and tax rates, and the minimization of deviations from the fiscal policy program framework is critical to effective policy coordination.

Chart 1: Primary Expenditures and Tax Revenues
(Percent of GDP)



Source: Ministry of Treasury and Finance.
* NEP (2019-2021) Realization estimation.
** NEP (2019-2021) program.

Chart 2: Cyclically-Adjusted Primary Budget Balance
(Percent of Potential GDP)



Source: Ministry of Treasury and Finance, CBRT calculations.
* Estimation.

[1] Since the public expenditures are determined largely by discretionary fiscal policies rather than economic fluctuations, cyclical adjustment was not performed for primary expenditures.