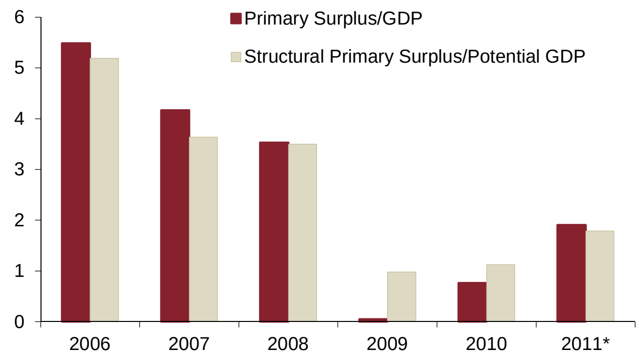
6. Public Finance

The favorable outlook in the public finance continued in the third quarter. The soaring tax revenues and falling interest expenditures were the major drivers of the improved budget balances in Turkey. In addition, within the scope of the law on restructuring of public claims (tax and insurance premium amnesty), applications of which were due on May 31, 2011, an additional budget revenue of about 1 percent of the GDP was envisioned in 2011. Furthermore, the relative slowdown in primary expenditures also contributed to the improvement in budget balance.

The MTP covering the 2012-2014 period was publicly announced in October. Accordingly, the central government primary balance for 2011 is expected to increase by 1.1 point compared to 2010. Meanwhile, the ratio of the cyclically adjusted structural primary surplus to potential GDP is expected to post a year-on-year increase by 0.7 point (Chart 6.1). In other words, in the event that the forecasts under the MTP are realized, fiscal policy will be tightened in 2011.

Chart 6.1.
Central Government Primary Surplus and Structural Primary Surplus
(Percent of GDP and Potential GDP)



* Estimate. Includes revenues collected under Law 6111 on restructuring of public claims.
Source: MTP (2012-2014), Çebi, C. and Ü. Özlale, (2011), "Türkiye'de Yapısal Bütçe Dengesi ve Mali Duruş" (in Turkish), CBRT Working Paper No. 11/11.

Increases in indirect taxes, VAT on imports in particular, which are driven by the vigorous private consumption demand, in addition to revenues collected under the law on restructuring of public claims were particularly effective in the favorable outlook of the budget performance, thereby signaling that the improvement in fiscal balances was mainly due to cyclical factors as well as legal arrangements. As a matter of fact, excluding the revenues collected under the tax and social security premium amnesty, which account for approximately 1 percent of the GDP, the ratio of primary surplus to GDP remained unchanged and the ratio of structural primary surplus to potential GDP decreased in 2011.

The public finance outlook presented in the MTP points that the improvement in 2011, driven also by the robust economic recovery, will also continue in the forthcoming period. According to the MTP, primary expenditures are envisioned to be lowered gradually. In addition, parallel to the rises as per legal and administrative arrangements, tax revenues and total public primary surplus are also expected to be gradually increased. Amid the decline in total public financing requirement, the public debt to GDP ratio is also expected to post a remarkable downtrend in the medium term (Table 6.1).

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

	2009	2010	2011*	2012**	2013**	2014**
Budget Revenues	22,5	23,0	22,7	23,1	22,9	22,5
Budget Expenditures	28,0	26,6	24,4	24,6	24,2	23,6
Budget Balance	**-5,5**	**-3,6**	**-1,7**	**-1,5**	**-1,4**	**-1,0**
Budget Revenues (Program-Defined)	21,0	21,8	22,0	22,1	22,0	21,8
Primary Expenditures (Program-Defined)	22,5	22,2	21,1	21,1	20,9	20,4
Primary Balance (Program-Defined)	**-1,5**	**-0,5**	**0,9**	**1,0**	**1,2**	**1,4**
Total Public Primary Balance (Program-Defined)	**-1,0**	**-0,2*****	**1,2**	**1,1**	**1,3**	**1,5**
EU-Defined Nominal Debt Stock	**46,1**	**42,2**	**39,8**	**37,0**	**35,0**	**32,0**

* Estimate.
** Target.
*** Realization estimate.
Source: MTP (2012-2014).

MTP targets point to a limited tightening in fiscal policy in the forthcoming period. Accordingly, medium-term projections in the final part of the Report are based on a framework that entails the increases in additional revenues to be acquired either by cyclical effects or legal arrangements like tax amnesty to be used in lowering the public debt without being transformed into expenditures. In this regard, inflation is not expected to be exposed to a public sector driven pressure. However, it should be emphasized that strengthening the fiscal structure by implementing institutional and structural reforms envisaged in the MTP remains critical in order to ensure a permanent fiscal discipline and to maintain Turkey's positive divergence from other emerging market economies.

6.1. Budget Developments

The central government budget and the primary balance posted a surplus of TL 0.2 billion and TL 35 billion, respectively (Table 6.1.1). The year-on-year improvement in the budget outturn in the first three quarters of 2011 was driven by rising tax revenues amid the economic recovery besides the fall in interest expenditures and the TL 11.4 billion collected under the law on restructuring of public claims by September. Additionally, the relative slowdown in primary expenditures also contributed to the decline in the budget deficit.

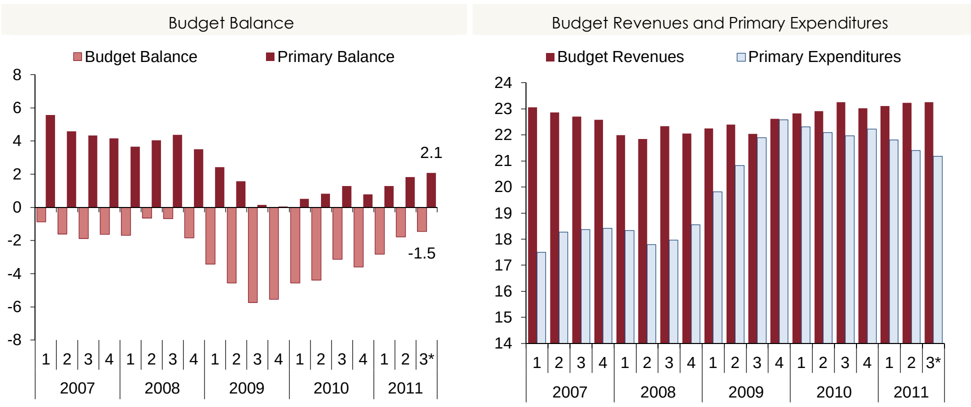
Table 6.1.1.
Central Government Budget Aggregates
(Billion TL)

	Jan.-Sept. 2010	Jan.-Sept. 2011	Rate of Increase (Percent)	Actual/Target (Percent)
Central Government Budget Expenditures	208.8	220.9	5.8	70.7
Interest Expenditures	39.3	34.8	-11.5	73.2
Primary Expenditures	169.5	186.1	9.8	70.2
Central Government Budget Revenues	187.5	221.1	17.9	79.2
I. Tax Revenues	153.8	188.4	22.5	81.1
II. Non-Tax Revenues	27.9	25.8	-7.5	65.4
Budget Balance	**-21.3**	**0.2**	**-**	**-**
Primary Balance	**18.0**	**35.0**	**94.5**	**250.8**

Source: Ministry of Finance.

Having slightly deteriorated due to sharp increases in primary expenditures in the last quarter of 2010, central government budget balance and primary budget balance to GDP ratios have started to improve amid the favorable budget outturn in the first three quarters of 2011 (Chart 6.1.1). The budget revenues to GDP ratio has edged up from end-2010 amid strong tax revenues and the law on restructuring public claims during the first three quarters of 2011, while the primary expenditures to GDP ratio displayed a decline in the first three quarters of 2011 compared to end-2010 figures (Chart 6.1.1).

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



* Estimate.
Source: Ministry of Finance.

Central government primary expenditures posted a year-on-year increase by 9.8 percent in the third quarter of 2011. The limited increase in primary expenditures was mainly attributed to the relatively low increase by 4.1 percent in current transfers, the major component of primary expenditures. Personnel expenditures, another major component of primary expenditures, were up 17 percent. Meanwhile, capital expenditures increased by about 18.9 percent, implying that public investments made a positive contribution to GDP growth in the first half of 2011 (Table 6.1.2).

Table 6.1.2.
Central Government Primary Expenditures
(Billion TL)

	Jan.-Sept. 2010	Jan.-Sept. 2011	Rate of Increase (Percent)	Actual/Target (Percent)
Primary Expenditures	**169.5**	**186.1**	**9.8**	**70.2**
1. Personnel Expenditures	47.4	55.5	17.0	76.7
2. Government Premiums to SSI	8.0	9.4	17.8	74.1
3. Purchase of Goods and Services	17.0	20.5	21.2	68.4
a) Defense and Security	5.6	6.0	7.4	59.7
b) Health Expenditures	3.8	4.0	4.1	80.3
4. Current Transfers	77.7	80.0	3.0	69.1
a) Duty Losses	2.7	1.2	-53.8	24.6
b) Health, Pension and Social Benefits	43.1	39.9	-7.4	64.0
c) Agricultural Support	5.0	5.7	15.8	95.6
d) Shares Reserved From Revenues	19.8	22.8	15.0	79.6
5. Capital Expenditures	12.2	14.5	18.9	67.0
6. Capital Transfers	2.8	2.7	-6.2	62.0

Source: Ministry of Finance.

Central government general budget revenues increased by a year-on-year 1.9 percent in the first three quarters of 2011. Tax revenues soared by 22.5 percent in the said period, while non-tax revenues, despite the increase in capital revenues, declined by 7.5 percent owing to the decrease in enterprises and property revenues as well as interest, shares and fines (Table 6.1.3). Amid the vigorous consumption demand in the first half, consumption-based taxes, mainly the value added tax on imports surged. Additionally, high levels of temporary corporate tax payments in February, May and August also contributed to the soaring tax revenues. The SCT revenues on the other hand, posted a relatively limited increase owing to the slowdown in the rate of increase in SCT on oil, natural gas and tobacco products.

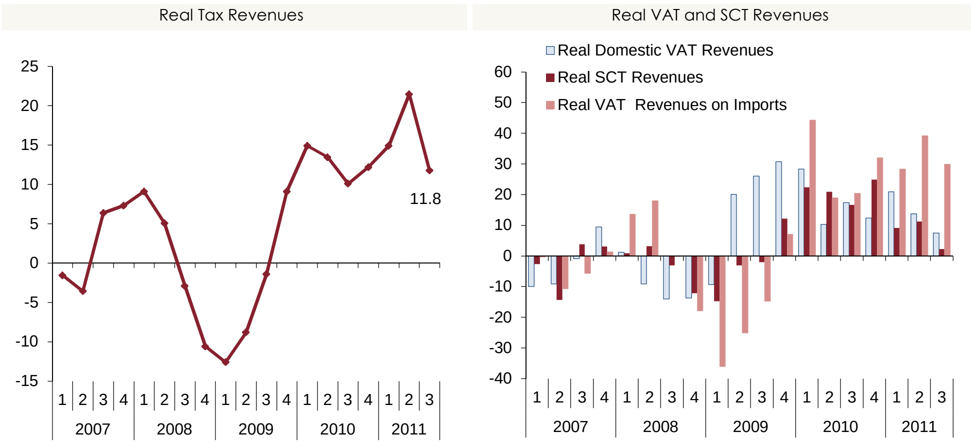
Table 6.1.3.
Central Government General Budget Revenues
(Billion TL)

	Jan.-Sept. 2010	Jan.-Sept. 2011	Rate of Increase (Percent)	Actual/Target (Percent)
General Budget Revenues	**181.7**	**214.2**	**17.9**	**78.8**
I-Tax Revenues	**153.8**	**188.4**	**22.5**	**81.1**
Income Tax	29.9	35.8	19.7	75.6
Corporate Tax	15.0	19.7	31.8	85.1
Domestic VAT	19.5	23.4	20.0	87.2
SCT	41.3	46.7	13.3	76.4
VAT on Imports	25.5	35.8	40.2	87.2
II-Non-Tax Revenues	**27.9**	**25.8**	**-7.5**	**65.4**
Enterprises and Property Revenues	8.3	7.5	-9.5	102.4
Interests, Shares and Fines	15.8	14.7	-6.6	71.2
Capital Revenues	2.3	2.4	3.2	23.7

Source: Ministry of Finance.

The annual rate of increase in real tax revenues, which has been on the rise since the fourth quarter of 2009 with the recovery of private consumption demand, slightly lost pace due to the waning base effects in the second and third quarters of 2010. Picking up sharply as of the last quarter of 2010, real tax revenues declined significantly in the third quarter of 2011, posting a year-on-year increase by only 11.8 percent due to the slowdown in the growth of the real VAT on imports and SCT revenues (Chart 6.1.2). The SCT revenues and VAT revenues on imports, major components of tax revenues, increased by 2.3 and 29.9 percent year-on-year, respectively, in real terms. Meanwhile, domestic VAT revenues rose by 7.5 percent year-on-year in real terms (Chart 6.1.2).

Chart 6.1.2.
Real Tax Revenues
(Percent of GDP)



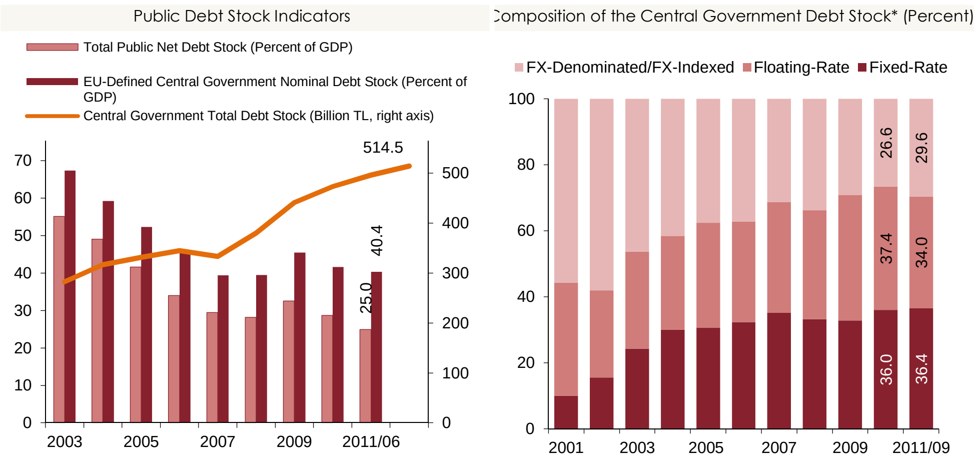
Source: Ministry of Finance.

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, and consequently the 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 the debt stock and a lower domestic debt rollover ratio. This favorable outlook also continued throughout the first nine months of 2011.

The central government debt stock increased by 8.6 percent from end-2010 to TL 514.5 billion in September 2011 (Chart 6.2.1). Changes in net domestic debt and net external debt accounted for an increase by TL 14 billion and a decrease by TL 1.6 billion, respectively, in central government debt. Meanwhile, due to the depreciation of the USD against the euro and the appreciation of the USD against the Turkish lira, parity and exchange rate effects brought central government debt up by TL 5.0 and 24.8 billion, respectively.

Chart 6.2.1.
Public Debt Stock Indicators

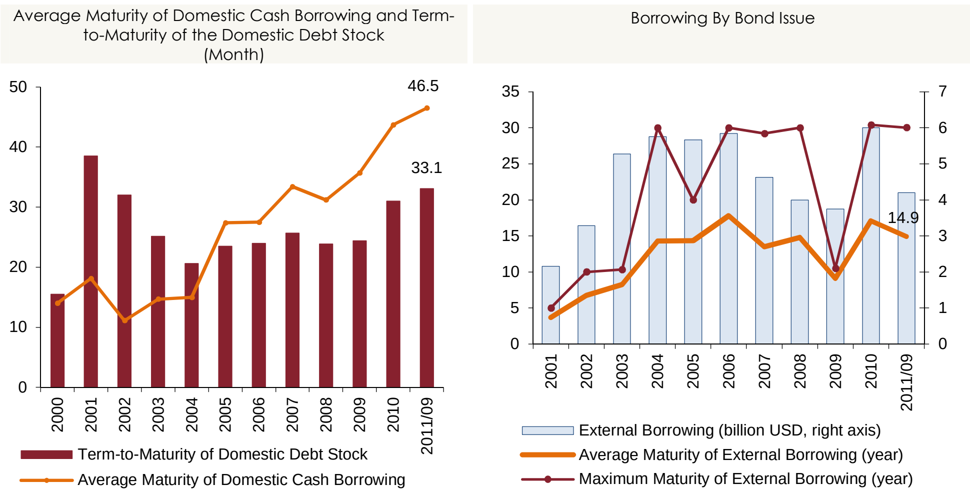


* Floating-Rate debt stock includes discounted securities with a maturity less than 1 year and GDBS with floating rates. FX-Denominated/FX-Indexed debt stock includes external debt stock and FX-denominated and FX-indexed domestic debt stock.
Source: Treasury, CBRT.

Public debt ratios posted a favorable outlook in the first half of 2011 amid ongoing economic recovery and the improving budget performance. The ratio of total net public debt stock and EU-defined general government nominal debt stock to GDP declined by 3.8 and 1.2 percentage points to 25.0 and 40.4 percent, respectively compared to the end-2010 figures (Chart 6.2.1).

The Treasury's financing program for 2011, as in the previous years, has been formulated based on an approach to limit the liquidity as well as interest and exchange rate sensitivity of the debt stock. In this regard, the share of fixed rate instruments in total debt stock remained unchanged in September 2011, compared to the same period of the previous year (Chart 6.2.1).

Chart 6.2.2.
Maturity of Borrowing from Domestic and External Markets

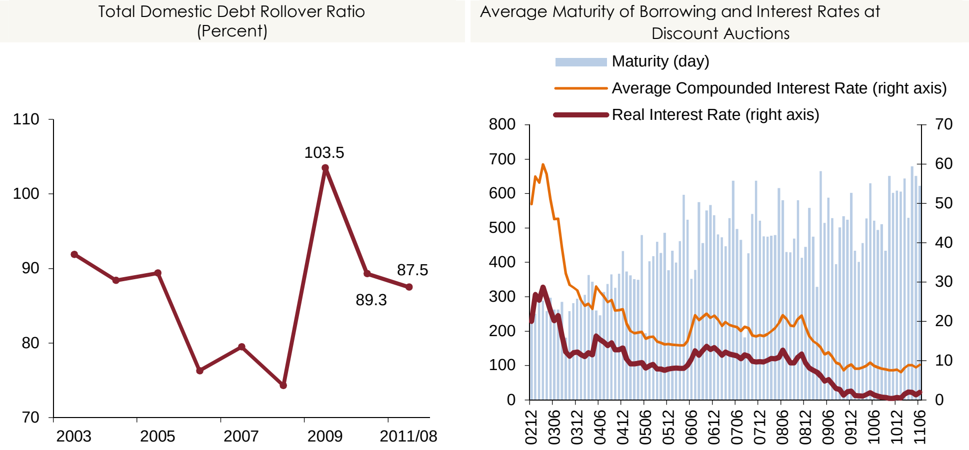


Source: Treasury, CBRT.

The financing strategy implemented to reduce liquidity risk continued in 2011. The ratio of public deposits to average monthly debt service is 258.3 percent as of September 2011. With an average maturity of domestic cash borrowing above 2010 averages, term-to-maturity of domestic debt stock increased to 33.1 months in September 2011 (Chart 6.2.2). Moreover, bond issues have yielded a long-term external debt of USD 4.2 billion in the first nine months of 2011, with an average maturity slightly down to 14.9 years from 2010 (Chart 6.2.2).

Having plunged from early 2009 until early 2011, the monthly average real interest rates at discount Treasury bill auctions remain low despite having posted slight increases in recent months (Chart 6.2.3). The extended average maturity of domestic borrowing besides low cost supports the favorable outlook for public debt sustainability.

Chart 6.2.3.
Domestic Borrowing



Source: Treasury, CBRT.

Domestic debt rollover ratio has been 87.5 percent as of the first eight months of 2011 (Chart 6.2.3). However, this ratio is expected to decline to 86.1 percent by the end of 2011 as envisaged by the Treasury's domestic borrowing strategy for October-December 2011.