6. Public Finance

The budget performance displayed a year-on-year improvement in the first three quarters of 2013. The faster increase in budget revenues relative to primary expenditures was influential on the improvement in the budget performance in this period. On the primary expenditures side, the increase in public investment expenditures was particularly noteworthy, while on the revenues side, tax revenues as well as non-tax revenues like privatization revenues had an upward trend. Hikes in tax rates in September 2012 and early 2013, payments by TEDAŞ and BOTAŞ on overdue liabilities and remarkable increases in consumption-based tax revenues owing to robust economic activity contributed significantly to soaring tax revenues.

The MTP covering the 2014-2016 period was announced to the public. The main priorities of the MTP were set as reducing the current account deficit, increasing domestic savings and growth potential and decreasing the inflation rate. In addition, the MTP stated that fiscal policy would be implemented in line with these objectives. In line with the tight fiscal policy, the MTP envisions both sustained fiscal discipline and gradual lowering of the debt stock to GDP ratio (Table 6.1). The envisioned fiscal accord is expected to be maintained via controlling primary expenditures, which in turn will pull down the budget revenues to the GDP ratio over time. In other words, the MTP aims at maintaining fiscal discipline in the medium term with a perspective that takes both primary expenditures and the tax burden under control.

The central government budget deficit to GDP ratio is expected to be 1.2 percent in 2013, with a 1 percentage point improvement compared to the previous MTP projections (Table 6.1). The expected improvement of the budget in 2013 is mostly owed to temporary one-time revenues. Hence, both the central government budget balance and the primary balance are envisioned to edge down in 2014, the start of the MTP period. However, budget balances are aimed toward a gradual improvement throughout the MTP period via cautious fiscal policies.

Table 6.1.
Central Government and General Government Budget Balance
(Percent of GDP)

	2012	2013*	2014**	2015**	2016**
Expenditures	25.6	26.1	25.4	24.6	23.7
Primary Expenditures	22.1	22.8	22.4	21.8	21.3
Interest Expenditures	3.4	3.2	3.0	2.8	2.4
Revenues	23.5	24.8	23.5	23.0	22.6
Tax Revenues	19.7	20.9	20.3	20.0	19.7
Other Revenues	3.8	4.0	3.2	3.0	2.9
Budget Balance	**-2.1**	**-1.2**	**-1.9**	**-1.6**	**-1.1**
Primary Balance	**1.3**	**2.0**	**1.1**	**1.2**	**1.3**
General Government Budget Balance	**-1.0**	**-1.0**	**-1.1**	**-0.8**	**-0.5**
General Government Primary Balance	**2.5**	**2.3**	**2.0**	**2.1**	**2.0**
EU-Defined Nominal Debt Stock	**36.2**	**35.0**	**33.0**	**31.0**	**30.0**

* Estimate.
** Target.
Source: MTP (2014-2016).

6.1. Budget Developments

The central government budget posted a deficit of 4.5 billion TL, while the primary budget registered a surplus of 39.3 billion TL in the first three quarters of 2013 (Table 6.1.1). Budget balances displayed a remarkable year-on-year improvement in this period. Even though the growth of primary expenditures is slightly above the year-end target, the high collection of consumption-based tax revenues and the relatively lower growth of interest expenditures influenced the budget improvement.

Table 6.1.1.
Central Government Budget Aggregates
(Billion TL)

	January-September 2012	January-September 2013	Rate of Increase (Percent)	Actual/Target (Percent)
Central Government Budget Expenditures	258.0	294.5	14.1	72.9
Interest Expenditures	39.5	43.8	10.9	82.7
Primary Expenditures	218.5	250.7	14.7	71.4
Central Government Budget Revenues	243.7	290.0	19.0	78.4
I. Tax Revenues	201.9	240.3	19.0	75.6
II. Non-Tax Revenues	33.2	40.4	21.8	93.6
Budget Balance	**-14.4**	**-4.5**	**-**	**13.2**
Primary Balance	**25.2**	**39.3**	**56.2**	**206.5**

Source: Ministry of Finance.

The central government budget deficit to GDP ratio, which soared in 2012 due to the slowdown in tax revenues and the acceleration in primary expenditures, is estimated to fall to 1.2 percent in the third quarter of 2013 (Chart 6.1.1). Having declined to 1.1 percent in the third quarter of 2012, the primary budget surplus to GDP has started to increase. Accordingly, the primary budget surplus to GDP ratio is estimated to reach 2.2 percent in the third quarter of 2013.

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

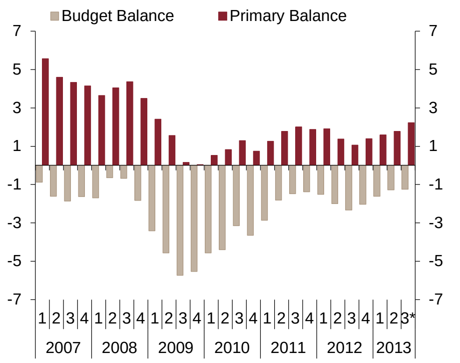
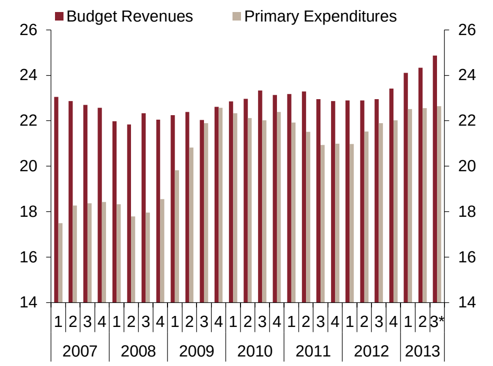


Chart 6.1.2.
Central Government Budget Revenues and Primary Expenditures
(Annualized, Percent of GDP)



* Estimate.
Source: Ministry of Finance.

Having surged due to the adoption of fiscal measures to contain the adverse effects of the 2009 global crisis on the Turkish economy, the central government primary expenditures to GDP ratio declined in the subsequent years, and reached 20.9 percent in the third quarter of 2011. However, the central government primary expenditures to GDP ratio has accelerated notably since the last quarter of 2011, and hit 22.6 percent in the third quarter of 2013 (Chart 6.1.2). Meanwhile, due to the tax adjustments in September 2012 and January 2013 as well as the relatively robust economic activity, the central government budget revenues to GDP ratio is estimated to reach 24.9 percent in the third quarter of 2013.

Table 6.1.2.
Central Government Primary Expenditures (Billion TL)

	January-September 2012	January-September 2013	Rate of Increase (Percent)	Actual/Target (Percent)
Primary Expenditures	**218.5**	**250.7**	**14.7**	**71.4**
1. Personnel Expenditures	65.9	73.3	11.3	75.4
2. Government Premiums to SSI	10.9	12.0	10.4	71.7
3. Purchase of Goods and Services	20,.4	21.6	6.3	64.7
4. Current Transfers	97.2	110.9	14.1	73.3
a) Duty Losses	2.1	2.9	36.3	64.0
b) Health, Pension and Social Benefits	50.2	54.9	9.4	75.3
c) Agricultural Support	6.8	7.4	8.6	82.7
d) Shares Reserved from Revenues	25.1	29.3	16.7	72.0
5. Capital Expenditures	15.6	22.3	42.7	66.6
6. Capital Transfers	2.6	3.8	46.6	74.2
7. Lending	6.0	6.7	12.3	60.2

Source: Ministry of Finance.

The central government primary budget expenditures, which started to surge as of the second half of 2012, increased further in the first half of 2013, albeit at a slower rate. Accordingly, the central government primary budget expenditures registered a year-on-year increase by 14.7 percent as of the third quarter of 2013 (Table 6.1.2).

In the first half of 2013, current transfers, personnel expenditures and purchase of goods and services, one of the major items in primary expenditures, registered a year-on-year increase by 14.1 percent, 11.3 percent and 6.3 percent, respectively. Expenditures on health, pension and social benefits registered a relatively slow growth, while shares reserved from revenues contributed to the increase in current transfers. As for other expenditure items, the surge in capital expenditures and capital transfers are noteworthy in the first nine months of 2013. Road construction expenditures played a major role on the increase by 42.7 percent in capital expenditures.

In the first nine months of 2013, the central government general budget revenues recorded a year-on-year increase by 19.4 percent (Table 6.1.3). In the same period, tax revenues and non-tax revenues increased by 19 percent and 21.8 percent, respectively.

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

	January-September 2012	January-September 2013	Rate of Increase (Percent)	Actual/Target (Percent)
General Budget Revenues	**235.1**	**280.7**	**19.4**	**77.7**
I-Tax Revenues	**201.9**	**240.3**	**19.0**	**75.6**
Income Tax	41.0	45.7	11.4	73.0
Corporate Tax	21.0	21.1	0.7	72.1
Domestic VAT	24.0	29.0	20.5	79.6
SCT	50.3	62.6	24.5	75.3
VAT on Imports	35.1	45.7	30.1	74.6
II-Non-Tax Revenues	**33.2**	**40.4**	**21.8**	**93.6**
Enterprises and Property Revenues	12.4	11.4	-8.3	124.4
Interests, Shares and Fines	16.2	18.2	12.0	81.0
Capital Revenues	1.9	9.4	391.0	101.3

Source: Ministry of Finance.

Tax revenues performed well on stronger domestic demand, the adoption of revenue-increasing measures in September 2012 and January 2013 and regular payments by BOTAŞ on overdue liabilities. Accordingly, the surge in consumption-based indirect tax revenues was noteworthy in the first nine months of 2013. During this period, SCT revenues surged by 24.5 percent on account of the rising tax revenues on oil and natural gas products, motor vehicles and alcoholic beverages. Concurrently, domestic VAT revenues posted an increase by 20.5 percent, while VAT revenues picked up after the slowdown in 2012 and went up by 30.1 percent on BOTAŞ payments.

In the first nine months of 2013, capital revenues, one of the major sub-items of non-tax revenues, registered a hike, while enterprises and property revenues declined slightly. The hike in capital revenues was essentially due to the increase in the privatization revenues. The decline in enterprises and property revenues, on the other hand, is attributed to the fall in the CBRT's profit transferred to the budget.

Having slowed down as of the third quarter of 2011, the annual rate of increase in real tax revenues recorded negative values in the second and third quarters of 2012 due to tax adjustments and the base effect. The annual rate of increase in real tax revenues returned positive amid tax rate hikes in September 2012 as well as the base effect, and reached 6.8 percent in the third quarter of 2013 (Chart 6.1.3).

Consumption-based tax revenues are the major tax revenue items that worsened due to the balancing of domestic and external demand in 2012. While this tax revenue item exhibited a particularly negative performance in the first three quarters of 2012, consumption-based tax revenues displayed a remarkable increase in the last quarter due to favorable base effect and adopted tax measures. Consumption-based tax revenues accelerated further in the first three quarters of 2013 on the back of tax measures adopted in January, the relatively robust economic activity and BOTAŞ payments. Accordingly, in the third quarter of 2013, VAT revenues on imports registered a year-on-year increase by 16.2 percent, while SCT revenues and domestic VAT revenues went up by 10.2 percent and 5.8 percent, respectively in real terms (Chart 6.1.4).

Chart 6.1.3.
Real Tax Revenues
(Annual Percent Change)

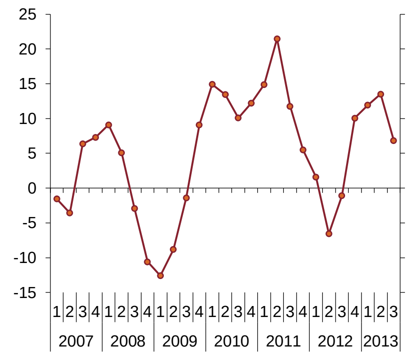
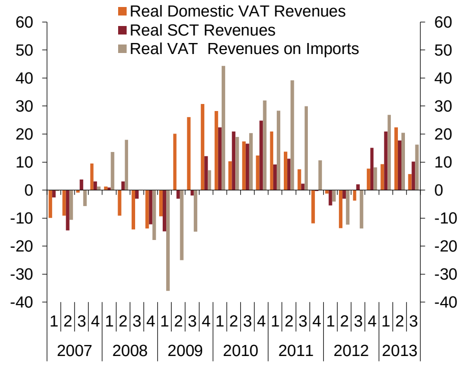


Chart 6.1.4.
Real VAT and SCT Revenues
(Annual Percent Change)



Source: Ministry of Finance.

6.2. Developments in the Public Debt Stock

Public debt stock indicators improved further in the third quarter of 2013. The ratio of total public net debt stock and the EU-defined general government nominal debt stock to GDP continued to decline; the real cost of borrowing stood low and the average maturity of the debt stock extended.

In September 2013, the central government debt stock displayed a slight year-on-year increase and reached 576.2 billion TL (Chart 6.2.1). In the second quarter of 2013, the ratio of total public net debt stock and the EU-defined general government nominal debt stock to GDP declined by 2.3 and 0.3 percentage points to 14.7 and 35.9 percent, respectively, compared to the end-2012 figures (Chart 6.2.1).

Chart 6.2.1.
Public Debt Stock Indicators

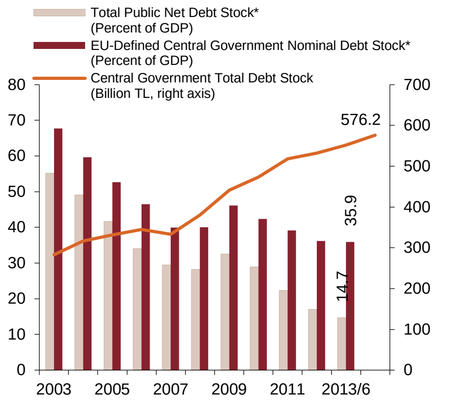
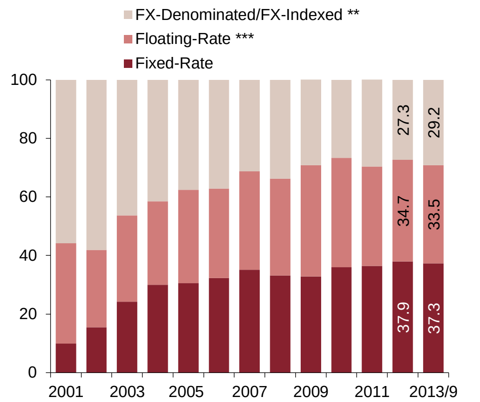


Chart 6.2.2.
Composition of the Central Government Debt Stock (Percent)



* CBRT's calculation. As of the second quarter of 2013 for debt stock to GDP ratios.
** FX-Denominated/FX-Indexed debt stock includes external debt stock and FX-denominated and FX-indexed domestic debt stock.
*** Floating-Rate debt stock includes discounted securities with a maturity less than 1 year and GDBS with floating rates.
Source: Treasury.

The Treasury had continued with its borrowing strategy to alleviate the sensitivity of the debt stock to liquidity, interest and exchange rate by the third quarter of 2013. Accordingly, the share of fixed-rate securities in the total debt stock remained unchanged from 2012 (Chart 6.2.2). As for the interest and exchange rate structure of the domestic borrowing, the share of fixed-rate securities registered a slight year-on-year decline, while the share of floating-rate securities increased in the first eight months of 2013. The ratio of public deposits to average monthly debt service is 259 percent. The average maturity of the domestic cash borrowing displayed a remarkable year-on-year increase in 2013, thereby raising the average term-to-maturity of the domestic debt stock to 43.7 months (Chart 6.2.3). External borrowing by bond issues amounted to 4.5 billion USD, with the average maturity standing at 15.9 years (Chart 6.2.4).

Chart 6.2.3.
Average Maturity of the Domestic Cash Borrowing and Term-to-Maturity of the Domestic Debt Stock
(Month)

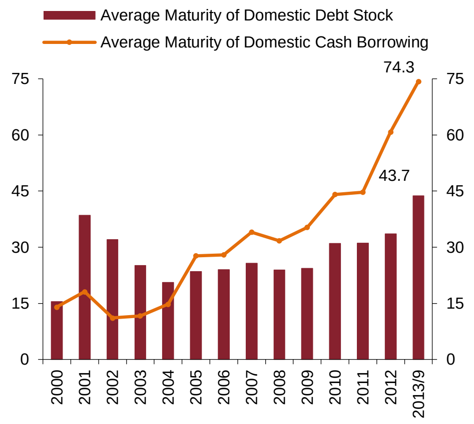
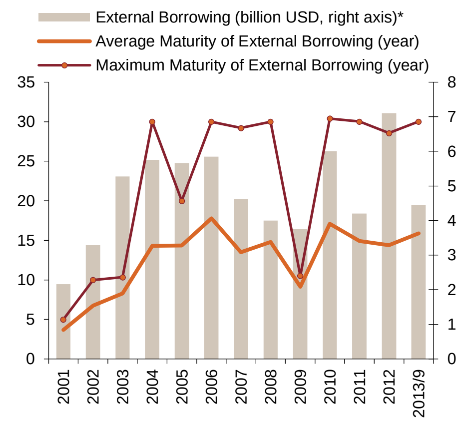


Chart 6.2.4.
Borrowing By Bond Issue



* Denotes total external borrowing for the relevant year.
Source: Treasury.

Domestic debt rollover ratio stood at 87.4 percent in end-August 2013 (Chart 6.2.5). Having slumped from early 2009 to early 2011 and reaching almost zero in end-2012 and early 2013, the average real interest rate at discount auctions surged amid the recent global fluctuations and the cautious monetary policy stance (Chart 6.2.6).[1]

Chart 6.2.5.
Total Domestic Debt Rollover Ratio
(Percent)

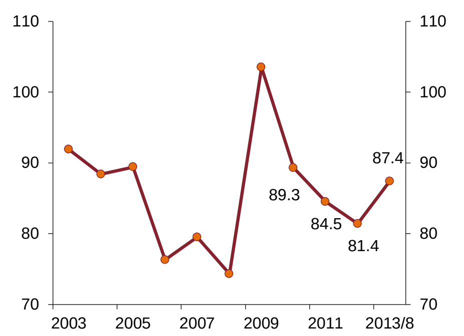
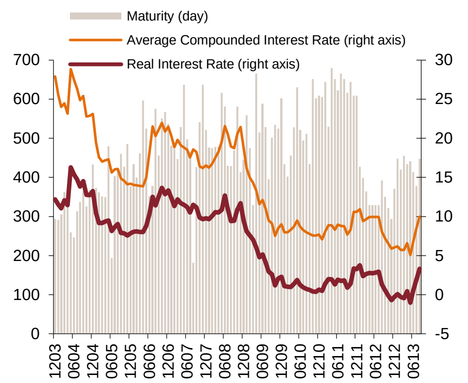


Chart 6.2.6.
Average Maturity of the Borrowing and Interest Rates at Discount Auctions



Source: Treasury, CBRT.

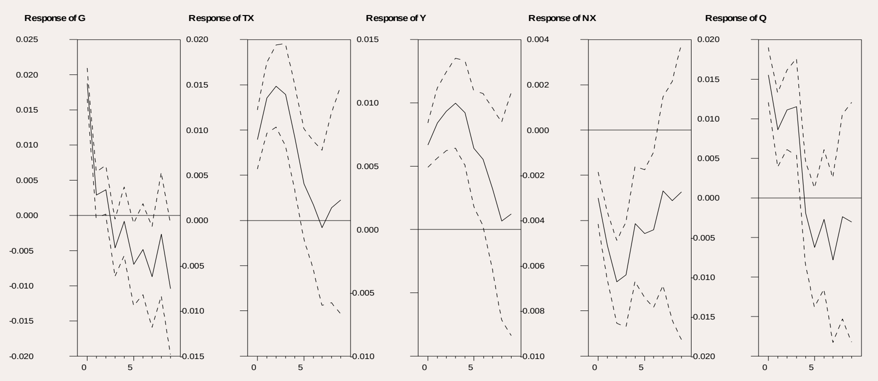
[1] Real interest rates are calculated by subtracting 12-month ahead CPI expectation (CBRT Survey of Expectations) from nominal interest rates (average annual compounded interest rate at the Treasury's TL-denominated zero-coupon securities auction).

Box 6.1 Effects of Public Spending Shocks on Real Exchange Rate and External Trade Deficit

This box summarizes the findings of the structural VAR model which analyzes the effects of public spending shocks on the real exchange rate and the external trade deficit in Turkey in the 2002Q1-2012Q4 period by using impulse response functions. [2] The baseline model includes primary expenditures (G), tax revenues (TX), national income (Y), real exchange rate (Q) and external trade balance (NX). Effects of the primary expenditures on the macroeconomic variable are analyzed in the baseline model and the same analysis is repeated for the effects of public consumption (wage and non-wage) and public investment spending, which are sub-items of public expenditures.

Chart 1 presents effects of shocks to public expenditures on the relevant variable (baseline model). An increase in the primary expenditures, as expected, leads to an instantaneous increase in national income, which continues over the subsequent period, reaching its maximum after the third quarter following the shock. The positive response of the national income to the primary expenditures shock is found to be permanent and statistically significant in the first 6-quarter period.

Chart 1. Impulse Responses to the Primary Expenditures Shock



[2] For further details, see Çebi and Çulha (2013).

Primary expenditures shock raises tax revenues (Chart 1). This finding can be explained in two ways: Firstly, an increase in the public spending leads to an increase in national income, thereby causing a rise in tax revenues. As shown in Chart 1, the impulse response of tax revenues to public spending shocks is very similar to that of the national income. Secondly, an increase in public expenditures widens the budget deficit, raising concerns over debt sustainability. Accordingly, the government adopts tax hikes to maintain fiscal discipline and ease concerns over debt sustainability. In fact, in order to maintain fiscal discipline following the 2001 crisis, the tax base was widened in Turkey via adjustments to tax regulation and tax revenues were raised. Hence, primary budget surplus targets were mostly attained in the years subsequent to the economic crisis. Fiscal expansion induced by higher public spending, which was followed by tax hikes, hints at a spending-driven tax adjustment process in Turkey.

Primary expenditures shock leads to real exchange rate appreciation and worsening of the external trade deficit (Chart 1). The appreciation of the real exchange rate continues for about a year, and is followed by a depreciation, which is not statistically significant. The impulse response of the external trade deficit to the public spending shock is mostly significant over the forecast horizon. In response to the public spending shock, the external trade deficit displays a significant deterioration in the subsequent two quarters, which is followed by improvement in the succeeding period.

Even though public spending shocks cause appreciation of the real exchange rate and deterioration in the external trade balance, the sub-items of public expenditures may have different effects on the relevant variables. To analyze the effects of shocks to sub-items of public expenditures, especially to public consumption (wage and non-wage) and investment spending on the real exchange rate and external trade balance, the primary expenditures variable in the baseline model is replaced by the public consumption and public investment spending, respectively. The findings show that shocks to the components of public spending have different effects on the real exchange rate and the external trade balance. Shocks to public consumption spending, especially non-wage (purchases of goods and services) lead to appreciation of the real exchange rate appreciation and worsening of the external trade balance, while shocks to public investment spending do not cause a statistically significant effect.

In sum, public spending shocks in Turkey cause appreciation of the real exchange rate and worsening of the external trade deficit while shocks to sub-items of public spending have different effects on the real exchange rate and the external trade deficit. These findings indicate the significance of fiscal discipline on current account dynamics, and hence, on the financial stability in the Turkish economy with a high current account deficit, which may cause considerable financial risks. As for the effect of the public spending shocks on fiscal variables, tax revenues are favorably affected by shocks to public expenditures, which is essentially due to the higher level of national income fuelled by higher public spending. Furthermore, tax adjustments in Turkey are induced by expenditures as distorted fiscal balances amid increased public spending urge governments to adopt tax hikes.

REFERENCES

Çebi, C. , A. Çulha, 2013, The Effects of Government Spending Shocks on the Real Exchange Rate and Trade Balance in Turkey, CBRT Working Paper No. 13/37.