6. Public Finance

In the first three quarters of 2015, the central government primary surplus posted a year-on-year increase, while the central government budget deficit edged slightly higher due to the relative upsurge in interest expenditures. Primary expenditures maintained the sharp uptrend of the recent years, while tax revenues performed better than expected and hovered above the target. In particular, indirect tax revenues such as SCT and VAT increased at a faster pace.

The MTP covering the 2016-2018 period has been announced. The MTP states that the fiscal policy will be implemented to support economic stability, to enhance growth potential, to reduce the current account deficit by increasing domestic savings and to contribute to price stability. To ensure that the fiscal policy helps achieve these goals, the budget will be allowed to become more flexible and the public savings-investment gap will be gradually narrowed by curbing the rate of increase in public spending and the public sector borrowing requirement. Moreover, public spending on infrastructure investments, trainings and R&D will be prioritized in order to support economic growth. Meanwhile, it is underlined that the quality of public revenues will be improved and therefore non-recurring revenues will no longer be used to finance policies that permanently raise the level of public spending in the medium to long term. Thus, tight fiscal standards are expected to help maintain fiscal discipline and bring the debt stock to GDP ratio further down gradually over the MTP period (Table 6.1). This fiscal adjustment is likely to be achieved by controlling the rate of increase in primary expenditures, and accordingly, the tax revenues to GDP ratio will edge down over time.

In 2015, the central government budget deficit to GDP is estimated to remain unchanged year-on-year at 1.3 percent (Table 6.1). As evidenced by the MTP projections for realizations, public spending was significantly higher than the target in 2015. However, thanks to the strong performance of tax revenues, the budget deficit is expected to deviate only marginally.

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

	2014	2015*	2016**	2017**	2018**
Expenditures	25.6	26.1	25.3	24.7	23.9
Primary Expenditures	22.8	23.3	22.7	22.2	21.5
Interest Expenditures	2.9	2.8	2.6	2.5	2.4
Revenues	24.3	24.8	24.5	24.0	23.5
Tax Revenues	20.1	21.1	20.7	20.6	20.5
Other Revenues	4.2	3.8	3.8	3.4	3.0
Budget Balance	**-1.3**	**-1.3**	**-0.7**	**-0.6**	**-0.4**
Primary Balance	**1.5**	**1.5**	**1.8**	**1.9**	**2.0**
General Government Budget Balance	**-0.6**	**0.0**	**-0.1**	**-0.2**	**0.0**
General Government Primary Balance	**2.3**	**2.9**	**2.5**	**2.4**	**2.5**
EU-Defined Nominal Debt Stock	**33.5**	**34.0**	**32.8**	**31.3**	**30.0**

* Forecast.
** MTP.
Source: MTP (2016-2018).

6.1. Budget Developments

During January-September 2015, the central government budget balance registered a deficit of 13.5 billion TL while the primary budget balance had 31.3 billion TL in surplus (Table 6.1.1). The central government primary balance recorded an increasing surplus whereas the central government budget balance posted a slightly higher deficit due to the relatively faster rise in interest expenditures in the first nine months of 2015 compared to the same period of the previous year.

Table 6.1.1.
Central Government Budget Aggregates
(Billion TL)

	2014 January-September	2015 January-September	Rate of Increase (Percent)	Actual/Target (Percent)
Central Government Budget Expenditures	325.4	367.7	13.0	77.7
Interest Expenditures	38.3	44.8	17.0	82.9
Primary Expenditures	287.2	322.9	12.4	77.1
Central Government Budget Revenues	313.5	354.2	13.0	78.4
I. Tax Revenues	258.7	298.3	15.3	76.6
II. Non-Tax Revenues	42.8	42.2	-1.6	81.9
Budget Balance	**-11.9**	**-13.5**	**-**	**-**
Primary Balance	**26.3**	**31.3**	**18.8**	**94.8**

Source: Ministry of Finance.

The central government budget deficit to the GDP ratio, which rose slightly in 2014, is estimated to hit 1.3 percent in the third quarter of 2015, remaining unchanged from the end-2014 level (Chart 6.1.1). Meanwhile, the primary budget surplus to the GDP ratio assumed an upward course and reached 2 percent at end-2013, after declining to 1.1 percent in the third quarter of 2012. This ratio dropped to 1.6 percent in 2014 and is estimated to rise to 1.7 percent in the third quarter of 2015.

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

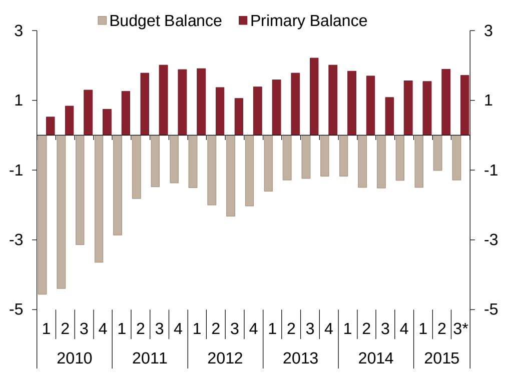
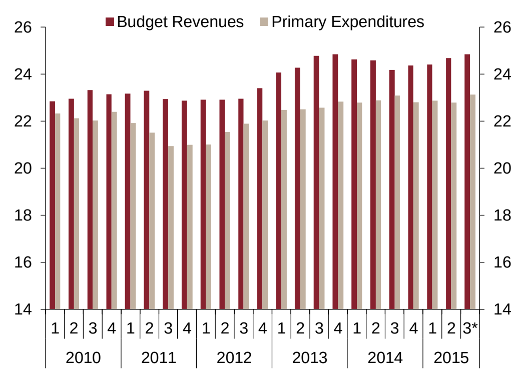


Chart 6.1.2.
Central Government Budget Revenues and Primary Expenditures
(Annualized, Percent of GDP)



* Forecast.
Source: Ministry of Finance.

Having surged since 2012 and reaching 22.8 percent at end-2013, the central government primary expenditures to GDP ratio hit 23.1 percent in the third quarter of 2014, which is the highest level recorded since 2008. This ratio fell slightly to 22.8 percent in the last quarter of 2014 and is expected to creep up to 23.1 percent in the third quarter of 2015 (Chart 6.1.2). On the other hand, the central government budget revenues to GDP ratio increased upon the relatively robust economic activity as well as tax adjustments in September 2012 and January 2013, reaching 24.8 percent at end-2013. This ratio dropped to 24.3 percent in 2014, mainly due to slowing tax revenues based on domestic demand, and is estimated to go up to 24.8 percent in the third quarter of 2015.

Trending upwards since the second half of 2012, the central government primary budget expenditures remained on the rise in the first nine months of 2015. Accordingly, the central government primary budget expenditures registered a year-on-year increase of 12.4 percent during January-September 2015 (Table 6.1.2).

Table 6.1.2.
Central Government Primary Expenditures (Billion TL)

	2014 January-September	2015 January-September	Rate of Increase (Percent)	Actual/Target (Percent)
Primary Expenditures	**287.2**	**322.9**	**12.4**	**77.1**
1. Personnel Expenditures	84.4	95.0	12.6	79.8
2. Government Premiums to SSI	14.1	15.5	9.9	76.3
3. Purchases of Goods and Services	24.6	28.4	15.3	69.0
4. Current Transfers	125.0	138.8	11.1	78.7
a) Duty Losses	2.0	3.0	50.2	67.4
b) Health, Pension and Social Benefits	62.3	63.3	1.6	78.5
c) Agricultural Support	7.8	8.4	8.4	84.4
d) Reserved Share Revenues	35.1	41.6	18.6	76.5
5. Capital Expenditures	27.0	29.9	10.8	73.1
6. Capital Transfers	4.3	5.6	30.1	81.7
7. Lending	7.8	9.7	23.6	91.8

Source: Ministry of Finance.

In the first nine months of 2015, purchases of goods and services as well as personnel expenditures, which are major items in primary expenditures, registered an increase of 15.3 and 12.6 percent, respectively, while current transfers were only up by 11.1 percent. The relatively limited rise in current transfers was caused by the mere increase by 1.6 percent in health, pension and social benefit expenditures. The shares reserved for other public institutions and enterprises from the central government revenues recorded a striking upswing of 18.6 percent, owing not only to the high central government tax revenue performance in the first nine months of 2015, but also to the termination of deductions made for debts of local administrations. Capital expenditures rose upon the rise in highway construction expenditures, while capital transfers increased notably due to capital transfers to special provincial administrations. The upsurge by 23.6 percent in lending resulted from the rise in loans extended to SEEs.

During January-September 2015, the central government general budget revenues recorded a year-on-year increase of 12.9 percent (Table 6.1.3). In this period, tax revenues performed strongly and rose by 15.3 percent, while non-tax revenues dropped slightly. A closer scrutiny of tax revenues reveals that the collection of consumption-based taxes and the income tax recorded a year-on-year upsurge in the first nine months of 2015. Meanwhile, corporate tax revenues hardly increased because of the weaker profitability of corporations and institutions. As income tax revenues are largely provided through withholding taxes on salaries and wages, the high increase in minimum wages in 2015 improved the collection of income taxes. Among consumption-based taxes, revenues from SCT, domestic VAT and VAT on imports recorded an uptick by 18.5, 17.8 and 13.4 percent, respectively. The details of SCT revenues show a jump of 45.2 percent in tax revenues on motor vehicles. The increase in the collection of taxes on petroleum and natural gas products, which account for a large share of total SCT revenues, remained relatively low at 11.9 percent.

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

	2014 January-September	2015 January-September	Rate of Increase (Percent)	Actual/Target (Percent)
General Budget Revenues	**301.5**	**340.4**	**12.9**	**77.f.,2**
I-Tax Revenues	258.7	298.3	15.3	76.6
Income Tax	53.2	61.9	16.5	75.2
Corporate Tax	24.1	24.5	1.5	67.8
Domestic VAT	29.3	34.5	17.8	78.0
SCT	65.4	77.4	18.5	82.4
VAT on Imports	47.1	53.4	13.4	71.1
II-Non-Tax Revenues	42.8	42.2	-1.6	81.9
Enterprises and Property Revenues	11.4	13.2	15.2	138.8
Interests, Shares and Fines	22.1	19.7	-10.6	68.4
Capital Revenues	6.8	7.2	6.2	68.9

Source: Ministry of Finance.

The unchanged performance of non-tax revenues on an annual basis is mainly attributed to the base effect generated by the one-time inclusion of 3 billion TL in the budget in March 2014 from the special provincial administrations, which were annulled by Law No. 6360. On the other hand, privatization revenues, which had been 5.3 billion TL in the first nine months of 2014, amounted to 6.1 billion TL in the same period of 2015.

Having turned positive amid tax rate hikes in September 2012 as well as the base effect, the annual rate of change in real tax revenues started to slacken in the third quarter of 2013, and real tax revenues remained unchanged year-on-year in the last quarter of 2014. Yet, real tax revenues posted a yearly increase of 6.7 percent in the third quarter of 2015 (Chart 6.1.3). The analysis of this increase by sub-items suggests that revenues from domestic VAT, SCT and VAT on imports, which are counted among consumption-based taxes, surged by 19.5, 9.3 and 3 percent in real terms, respectively (Chart 6.1.4).

Chart 6.1.3.
Real Tax Revenues
(Annual Percent Change)

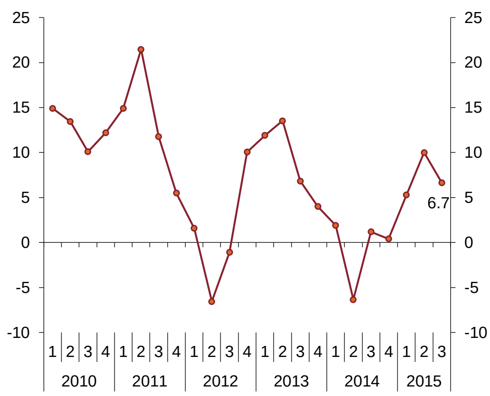
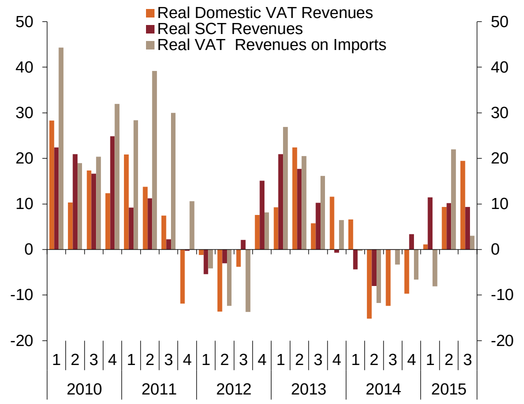


Chart 6.1.4.
Real VAT and SCT Revenues
(Annual Percent Change)

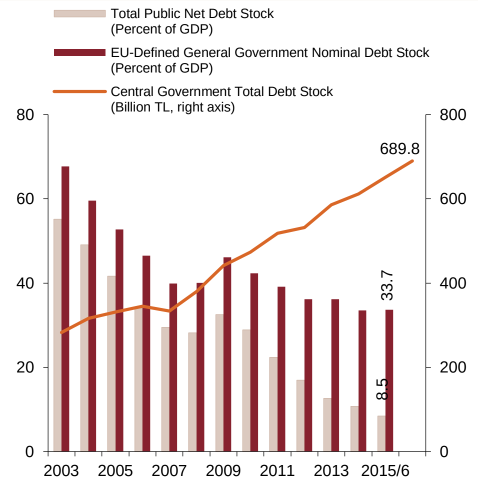


Source: Ministry of Finance.

6.2. Developments in the Public Debt Stock

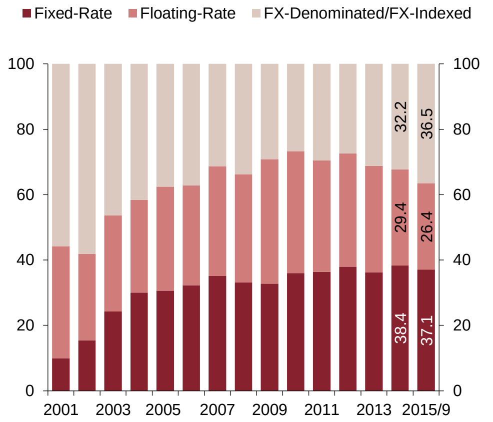
The central government debt stock reached 689.8 billion TL in September 2015 (Chart 6.2.1). In the first half of the year, the ratio of the total public net debt stock to GDP decreased by 2.2 points from end-2014, while the EU-defined general government nominal debt stock to GDP ratio remained virtually unchanged (Chart 6.2.1).

Chart 6.2.1.
Public Debt Stock Indicators



Source: Treasury.

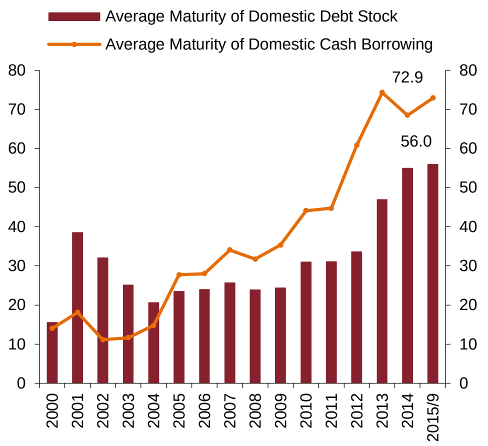
Chart 6.2.2.
Composition of the Central Government Debt Stock*
(Percent)



* FX-Denominated/FX-Indexed debt stock includes external debt stock and FX-denominated and FX-indexed domestic debt stock.
Source: Treasury.

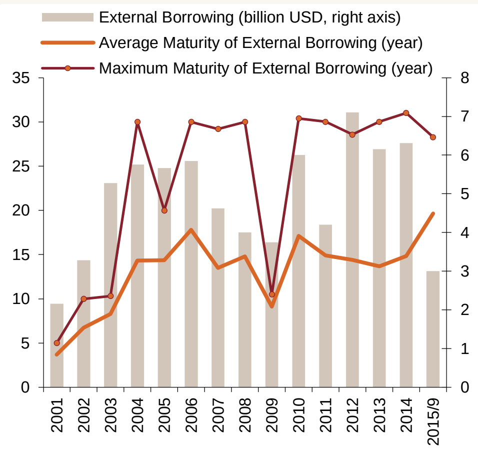
The share of fixed-rate securities in the total debt stock was slightly down from 2014 (Chart 6.2.2). With respect to the interest rate structure of domestic borrowing, the share of fixed-rate borrowing increased annually in the first eight months of 2015. Meanwhile, the ratio of public deposits to average monthly debt service stands at 313.9 percent. The average term-to-maturity of the domestic debt stock equaled 56 months (Chart 6.2.3). External borrowing by bond issues amounted to 3 billion USD, with an average maturity of 19.7 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)



Source: Treasury.

Chart 6.2.4.
Borrowing By Bond Issue



The domestic debt rollover ratio ended August 2015 at 86.9 percent (Chart 6.2.5). The average real interest rate[1] has been on the rise since early 2015 (Chart 6.2.6).

Chart 6.2.5.
Total Domestic Debt Rollover Ratio
(Percent)

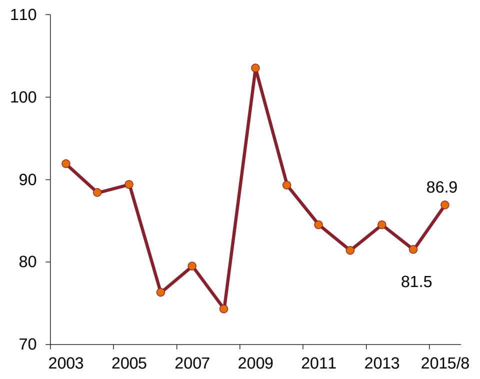
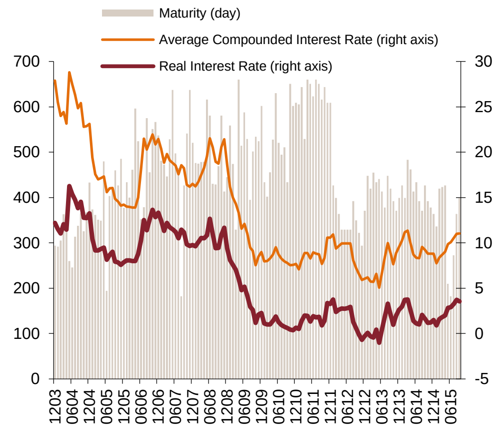


Chart 6.2.6.
Average Maturity and Interest Rates of Borrowing at Discount Auctions



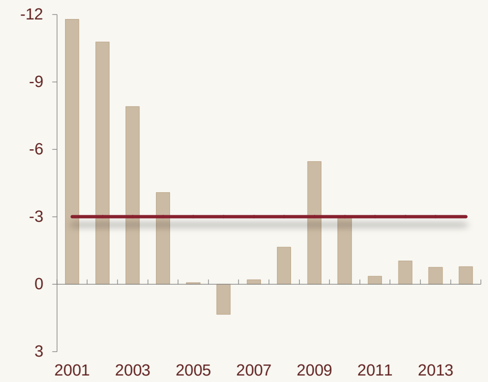
Source: Treasury, CBRT.

[1] Real interest rates are calculated by subtracting the 12-month-ahead inflation expectations of the 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 Public Debt Stock and Budget Deficit Developments: An International Comparison

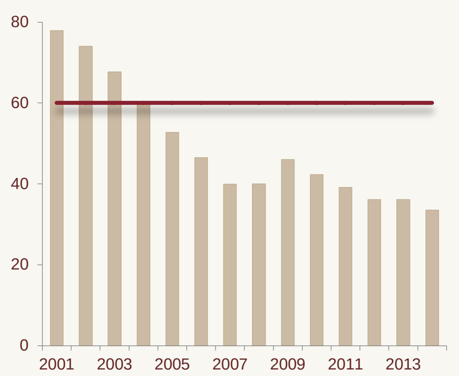
Fiscal balances improved substantially in the Turkish economy with the uninterrupted implementation of a tight fiscal policy on the back of structural reforms and measures for fiscal discipline introduced in the aftermath of the crisis in February 2001. Having hovered at around 12 percent in 2001, the general government budget deficit to GDP ratio fell below the Maastricht criterion of 3 percent in 2005 with tightened fiscal policy, and even reached positive values in 2006, thus yielding a surplus (Chart 1). Likewise, the public debt stock to GDP ratio dropped below the Maastricht criterion of 60 percent in 2004, down from 78 percent in 2001, and remained on the decline in the following years (Chart 2).

Chart 1. General Government Budget Deficit
(Percent of GDP)



Source: Ministry of Development.

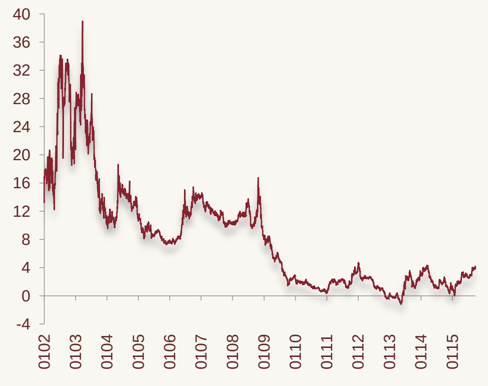
Chart 2. Public Debt Stock
(Percent of GDP)



Source: Treasury.

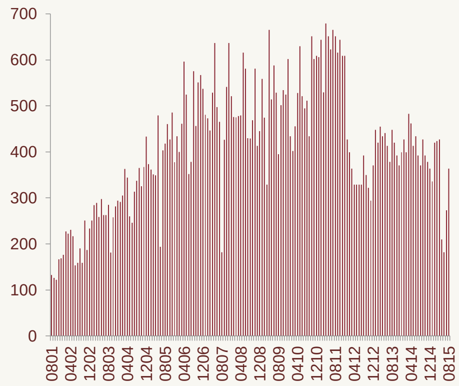
Thanks to the favorable fiscal performance, the borrowing cost of the Treasury has dropped markedly starting from end-2003 (Chart 3) and the maturity of borrowing began to extend significantly (Chart 4). Following the dramatic fall in the public debt stock to GDP ratio, the debt sustainability issue, one of the most fundamental items in the economic itineraries of the post-2001 period, has been off the agenda as of 2005.

Chart 3. Real Interest Rates
(2-Year Treasury Bond Rates)



Source: BIST, CBRT.

Chart 4. Average Maturity of Borrowing
(Day)



Source: Treasury.

The comprehensive fiscal stimulus packages and financial relief program implemented in 2009 against the adverse effects of the global crisis caused public deficit and debt stock to soar globally, particularly across advanced economies. In addition, the crisis-led economic contraction caused tax revenues to fall, accelerating the rise in budget deficits. In line with the global fiscal trends, budget deficit and debt stock to GDP ratio also increased notably in Turkey in 2009. In the subsequent years, however, the gradual withdrawal of fiscal incentives, collection of higher tax revenues on the back of the robust economic recovery and steps taken to promote budget discipline helped improve fiscal balances (Charts 1 and 2), causing domestic borrowing rates to drop dramatically and the maturity of borrowing to re-settle on an upward track (Charts 3 and 4).

The lower output capacity and reduced tax revenues during the global crisis had negative repercussions on budget balances across emerging economies, including Turkey. The ratio of budget deficit to GDP adjusted for purchasing power parity in such economies climbed to 5 percent in 2009 from almost zero in 2007 (IMF, 2010). Yet, the fact that the emerging economies had relatively lower budget deficit and debt stock at the onset of the crisis and that they adopted less comprehensive fiscal stimulus packages afterwards had a major impact on their fiscal performance. Accordingly, emerging economies saw their budget balances recover more rapidly during the post-crisis period, also given their relatively faster rebound.

On the fiscal balances front, Turkey performed much stronger than other emerging market economies, particularly after the global crisis, owing to the sustained fiscal discipline. According to IMF forecasts, Turkey's general government budget balance to GDP ratio and general government primary balance to GDP ratio are expected to be -1.4 percent (Chart 5) and 1.4 percent (Chart 6), respectively, in 2015. Both ratios are notably better than those for other emerging economies.

Chart 5. 2015 Forecasts for General Government Budget Balance
(Percent of GDP)

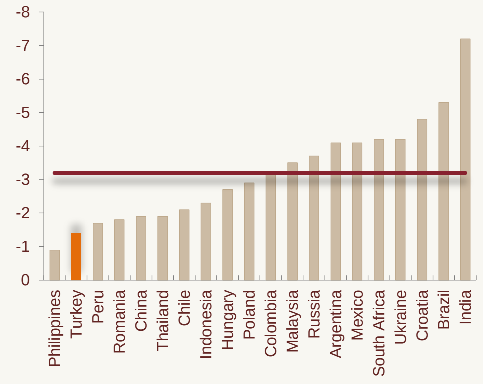
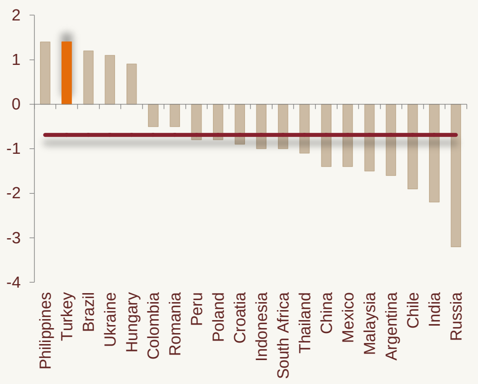


Chart 6. 2015 Forecasts for General Government Primary Balance
(Percent of GDP)



Source: IMF Fiscal Monitor, April 2015.

Similarly, the IMF also estimates that Turkey's public debt stock to GDP ratio and gross financing need[2] to GDP ratio will amount to 33.4 percent (Chart 7) and 5.7 percent (Chart 8), respectively, in 2015. Both ratios, which are critical for macroeconomic stability, appear significantly lower than the averages of emerging economies.

[2] Gross financing need for a certain year is the sum of the public borrowing requirement (general government budget deficit) and the maturing government debt of that year.

Chart 7. 2015 Forecasts for Public Debt Stock
(Percent of GDP)

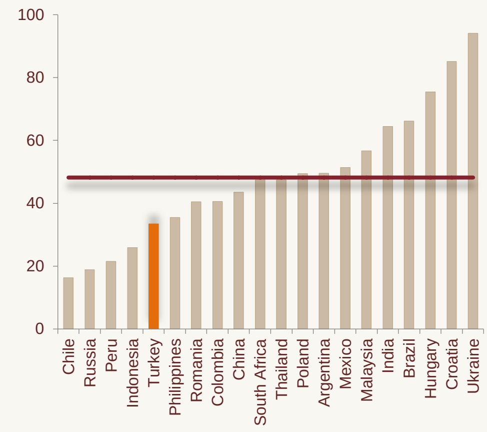
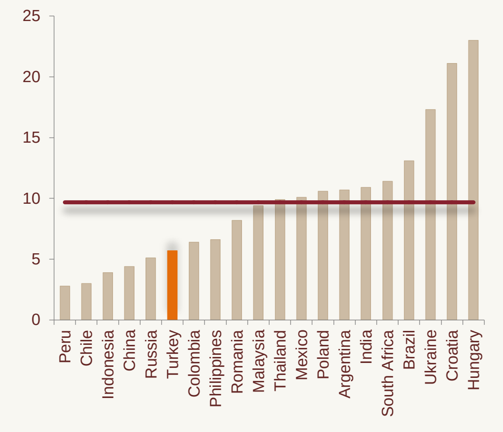


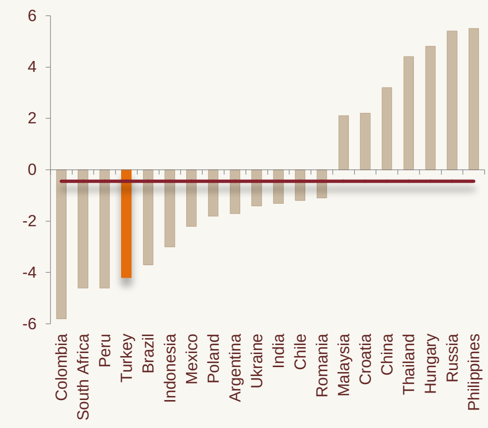
Chart 8. 2015 Forecasts for Public Financing Needs
(Percent of GDP)



Source: IMF Fiscal Monitor, April 2015.

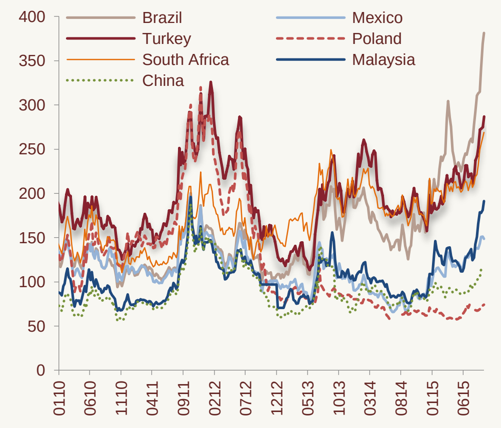
Turkey's relatively higher current account deficit and the recent uncertainties surrounding international financial markets caused CDS premiums to rise across all emerging economies, including Turkey (Charts 9 and 10). The CBRT's new monetary policy framework, which has been in effect since end-2010 to observe both price stability and financial stability, has been effective in restraining macrofinancial risks as well as improving the current account. Likewise, macroprudential measures adopted by the BRSA contributed largely to these efforts. Along with the cautious fiscal stance, the implementation of the new monetary policy framework and the adoption of macroprudential policies have strengthened Turkey's resilience against external uncertainties.

Chart 9. 2015 Forecasts for Current Account Balance
(Percent of GDP)



Source: WEO, April 2015.

Chart 10. Selected CDS Rates
(5-year, Basis Points)



Source: Bloomberg.

In conclusion, compared to its peers in other emerging economies, Turkey exhibits a favorable fiscal performance and has a relatively larger room for maneuvering fiscal policies, which may discretionarily be implemented to restore macroeconomic stability. Together with the robustness of the financial system, this has been one of the major drivers of Turkey's improvement in relative riskiness and the decline in real rates during and after the global crisis. It is crucial to maintain and strengthen these fiscal achievements in the current environment of elevated downside risks on capital flows to emerging economies fueled by declining global risk appetite amid heightened uncertainties over global financial markets. Any measure that would ensure the sustainability of fiscal discipline and reduce the savings deficit will support macroeconomic stability and contribute positively to social welfare by keeping long-term interest rates at low levels.

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