6. Public Finance

In the first half of 2018, fiscal policy supported economic growth through not only measures and incentives introduced, but also via public consumption expenditures and particularly investment expenditures. Nevertheless, due to the expenditures caused by incentives introduced to boost investment, employment and exports as well as the increase in current transfer expenditures, the budget deficit widened in the first half. Although the slowdown in the economic activity projected for the second half will likely cause a decline in tax revenues, it was stated in the New Economy Program (NEP for 2019-2021) announced in September that the rise in the budget deficit would be curbed via savings on primary government spending.

In the January-September period, despite the favorable performance of budget revenues, the budget deficit widened significantly compared to the same period last year due to the rise in interest and primary expenditures. In the rest of the year, the rise in the budget deficit is expected to be curbed by measures taken towards decreasing primary budget expenditures and the revenues to be obtained from restructuring of taxes and some other receivables, the zoning amnesty and military service compensation fees.

In the New Economy Program announced in September, it was stated that the tight monetary and fiscal policies would be carried out in coordination and fiscal discipline would be the primary supporter of the macro-rebalancing process. The fiscal adjustment projected in the NEP presents a framework in which the ratio of primary expenditures to GDP will be decreased gradually throughout the NEP period while the ratio of tax revenues to GDP will be gradually increased, albeit relatively more moderately (Box 6.1).

In 2017, the public financing need, which had increased on the back of the expansionary fiscal policy introduced to underpin economic activity, was mostly met through domestic borrowing, and the domestic debt roll-over ratio stood at 125.6 percent. In January-September 2018, the rise in the budget deficit and the decline in net external borrowing were largely financed by domestic borrowing while public deposit savings were also partly used to meet the financing need. In this period, the domestic roll-over ratio was 107.6 percent and the external debt roll-over ratio was 43 percent.

6.1 Budget Developments

The central government budget deficit, which was TL 31.6 billion in the January-September period of 2017, increased to TL 56.7 billion in the same period of 2018 (Table 6.1.1). The budget deficit posted a year-on-year increase due to budget expenditures that proved higher than budget revenues. Interest expenditures, which increased on the back of the rise in borrowing costs, were one of the factors fueling budget deficit. The primary budget continued to be in surplus in the first nine months of the year, albeit slightly lower compared to the same period of last year.

Table 6.1.1: Central Government Budget (Billion TL)

	January-September 2017	January-September 2018	Rate of Increase (%)	Realization/ Budget Target (%)
Central Government Budget Expenditures	488.2	603.5	23.6	79.1
Interest Expenditures	46.6	60.4	29.7	84.3
Primary Budget Expenditures	441.6	543.1	23.0	78.6
Central Government Budget Revenues	456.6	546.8	19.8	78.5
I. Tax Revenues	385.3	459.4	19.2	76.6
II. Non-Tax Revenues	71.3	87.5	22.7	89.8
Budget Balance	-31.6	-56.7	79.4	86.0
Primary Balance	15.0	3.7	-75.3	63.9

Source: Ministry of Treasury and Finance.

The ratio of annualized budget deficit to GDP is estimated to be 2 percent while the ratio of primary budget balance to GDP is expected to be -0.1 percent in September (Chart 6.1.1).
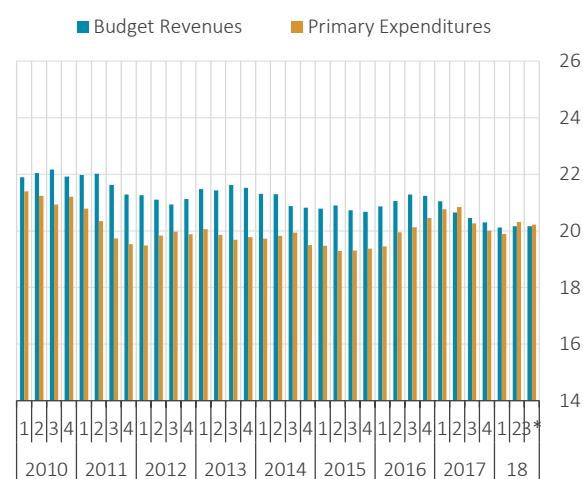
Chart 6.1.1: Central Government Budget Balances (Annualized, % of GDP)
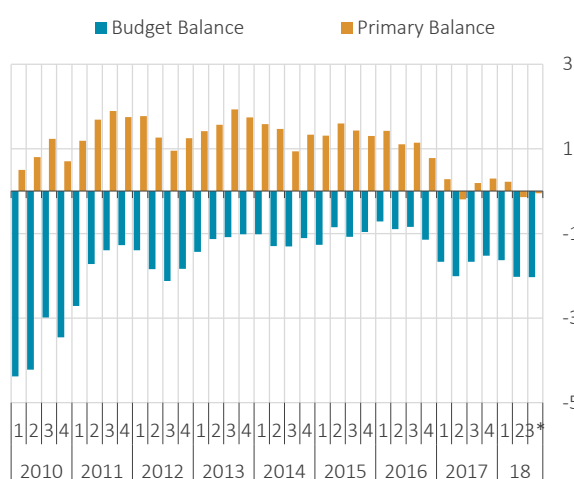
Source: Ministry of Treasury and Finance.
*Forecast.

Chart 6.1.2: Central Government Budget Revenues and Primary Expenditures (Annualized, % of GDP)

Source: Ministry of Treasury and Finance.
*Forecast.

In the third quarter, the central government primary expenditures to GDP ratio remained almost the same as its level in the same period last year and stood at 20.2 percent while central government budget revenues to GDP ratio is estimated to exhibit a year-on-year decline to 20.2 (Chart 6.1.2).

Central government primary budget expenditures rose by 23 percent year-on-year to TL 543.1 billion in January-September 2018 period (Table 6.1.2). Meanwhile, current transfers, the most significant item among primary expenditures, posted a rather limited rise of 18.9 percent in the January-September 2018 period. The grant payments to retirees made in June and August led to a rise in current transfers in the first nine months of the year, while the base effect stemming from the postponement of insurance premium payments for the first three months of 2017 to the last quarter of the year dampened health, pension and social benefit expenditures and limited the increase in current transfers. One of the key drivers of the rapid rise in transfers to households is estimated to be transfers to Public-Private Sector Partnership (PPP) projects. In this period, capital expenditures and capital transfers, which are indicatives of public investments, displayed a remarkable upsurge. The lending item increased significantly due to

two reasons: first, partial payment by the Ministry of Finance of the accumulated debts stemming from medical material and medicine purchases by university hospitals and second, the transfers to the Credit Guarantee Fund (CGF).

Table 6.1.2: Central Government Primary Expenditures (Billion USD)

	January-September 2017	January-September 2018	Rate of Increase (%)	Realization/ Budget Target (%)
Primary Budget Expenditures	441.6	543.1	23.0	78.6
1. Personnel Expenditures	122.7	150.6	22.8	82.3
2. State Premium Payments to SSI	20.2	25.0	23.8	81.2
3. Purchase of Goods and Services	40.6	46.4	14.5	70.3
4. Current Transfers	204.1	242.6	18.9	81.0
a) Duty Losses	4.7	5.6	19.4	80.4
b) Health, Pension and Social Benefit Expenditures	103.9	114.9	10.6	84.7
c) Agricultural Support Payment	10.0	10.8	8.1	74.5
d) Allocated Revenues	52.8	69.9	32.5	77.8
e) Household Transfers	11.7	17.3	47.8	81.5
5. Capital Expenditures	37.4	52.2	39.6	75.9
6. Capital Transfers	7.4	10.7	45.1	70.1
7. Lending	9.3	15.5	66.3	76.7

Source: Treasury and the Ministry of Finance.

Central government general budget revenues increased by 19.8 percent year-on-year to TL 527 billion in the first nine months of 2018 (Table 6.1.3). Revenues generated by the income tax, corporate tax and VAT on imports performed quite well, while the rise in domestic VAT revenues and SCT (Special Consumption Tax) collection remained limited due to the slowdown in domestic demand and the tax reductions on fuel oil. Actually, the amount of SCT collected on oil and natural gas products decreased year-on-year because of the sliding scale system introduced in mid-May while the SCT collection also fell due to the declining automobile sales. The upsurge in VAT on imports is attributed to the rise in the exchange rates. As for non-tax revenues the decline in privatization revenues became stronger, the rise in property income was relatively stronger owing to the Central Bank's profit transfer in April; revenues from interests, shares and fines increased rapidly on the back of the military service compensation fees and zoning amnesty (Table 6.1.3). By end-September, the amount transferred to the Government budget from the zoning amnesty and paid military service revenues was TL 3.1 billion and TL 3.4 billion, respectively. In the upcoming period, revenues to be generated by the restructuring of taxes and other receivables, and proceeds from the zoning amnesty and paid military service are expected to have a positive effect on budget revenues.

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

|	January-September 2017	January-September 2018	Rate of Increase (%)	Realization/ Budget Target (%)
General Budget Revenues	**439.9**	**527.0**	**19.8**	**77.3**
I-Tax Revenues	**385.3**	**459.4**	**19.2**	**76.6**
Income Tax	79.5	99.8	25.5	81.3
Corporate Tax	39.9	52.9	32.4	80.3
Domestic VAT	41.1	45.7	11.3	69.3
SCT	98.8	102.8	4.0	70.1
VAT on Imports	68.2	89.4	31.0	82.9
II-Non-Tax Revenues	**54.6**	**67.6**	**24.0**	**82.6**
Enterprise and Property Revenues	16.7	22.3	33.5	110.9
Interests, Shares and Fines	25.8	37.8	46.5	81.4
Capital Revenues	9.0	5.8	-35.7	48.1

Source: Treasury and the Ministry of Finance.

Real tax revenues decreased slightly in the third quarter (Chart 6.1.3). An analysis by sub-items reveals that VAT on imports increased in real terms while VAT and SCT revenues decreased, in real terms again (Chart 6.1.4).

Chart 6.1.3: Real Tax Revenues (Year-on-Year Percentage Change)
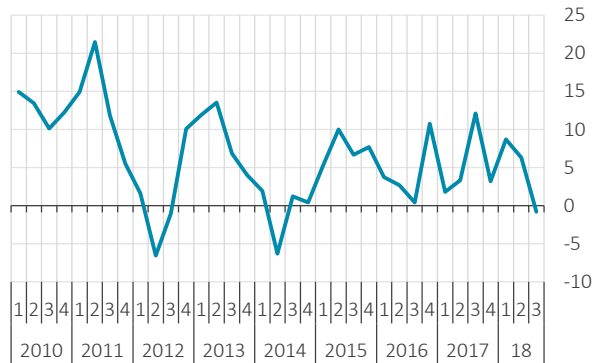
Source: Ministry of Treasury and Finance.

Chart 6.1.4: Real VAT and SCT Revenues (Year-on-Year Percentage Change)
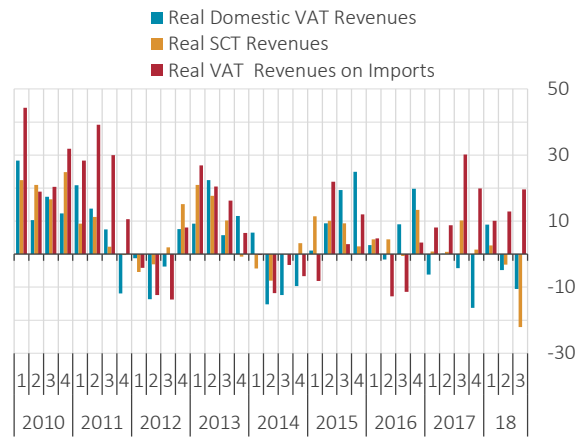
Source: Ministry of Treasury and Finance.

6.2 Developments in the Public Debt Stock

In the first half of 2018, the EU-defined general government debt stock to GDP ratio increased by 0.9 points to 29.2 percent in year-on-year terms; the realization estimate for 2018 was stated as 31.1 percent in the NEP (Chart 6.2.1).
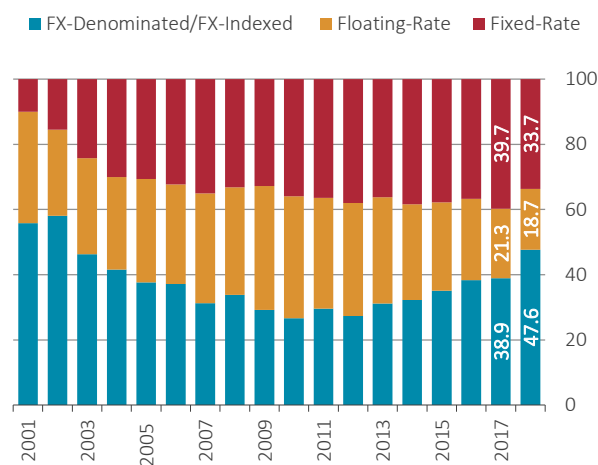
Chart 6.2.1: Public Debt Stock Indicators
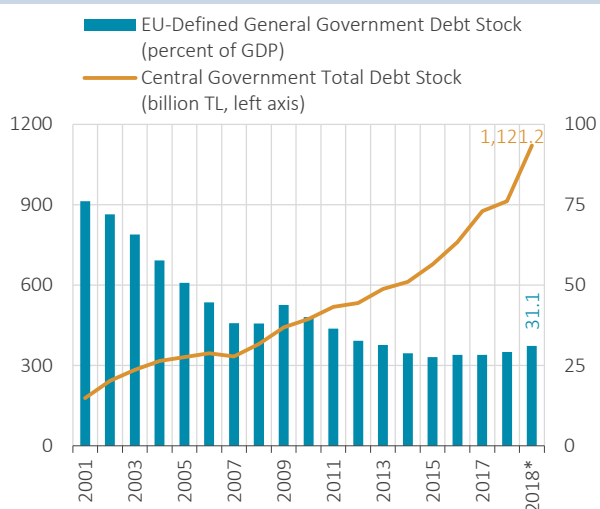
Source: Ministry of Treasury and Finance.
* Actual central government total debt stock figure for
September 2018; NEP EU-defined general government
debt stock realization estimate for 2018.

**Chart 6.2.2: Composition of the Central Government Debt Stock * (%)**

Source: Ministry of Treasury and Finance.
* As of September.

By September 2018, the shares of fixed-rate and floating-rate securities in the total debt stock have decreased compared to 2017, while those of FX-denominated and FX-indexed securities increased significantly due to the depreciation of exchange rates (Chart 6.2.2). Domestic borrowing has been mostly financed by fixed-rate securities in this period.
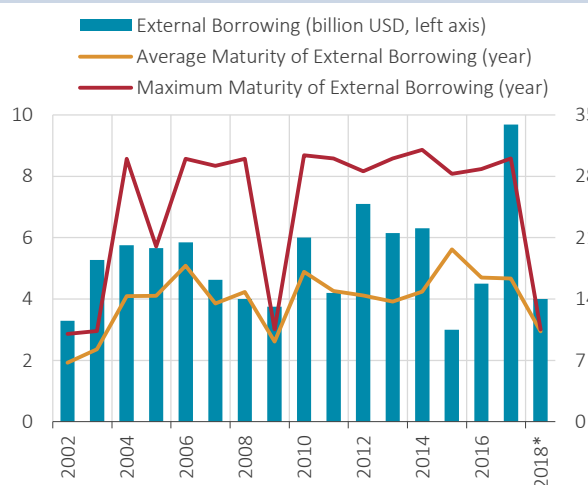
Chart 6.2.3: Average Maturity of Domestic Cash Borrowing and the Average Term-to-Maturity of the Domestic Debt Stock (Month)
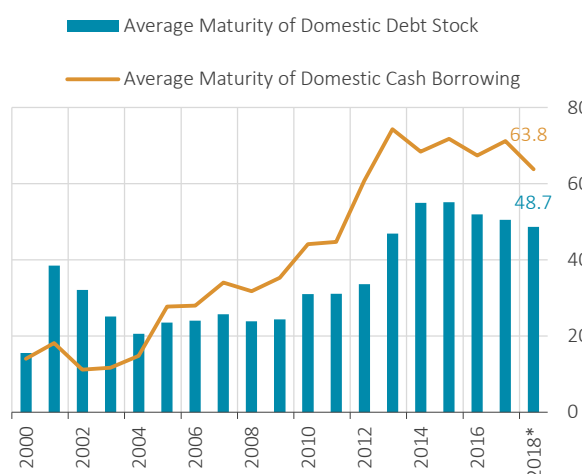
Source: Ministry of Treasury and Finance.
* As of September.

Chart 6.2.4: External Borrowing through Bond Issues

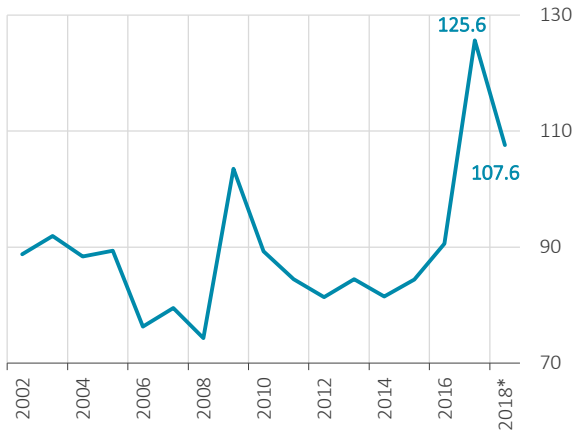

Source: Ministry of Treasury and Finance.
* As of September.

The average term-to-maturity of the domestic debt stock stood at 48.7 months as of September 2018 (Chart 6.2.3). In January-September 2018, the amount of external borrowing by bond issues was USD 4 billion, with an average maturity of 10.3 years (Chart 6.2.4). The external debt rollover ratio declined compared to last year realizing at 43 percent in September 2018. In the same period, the Treasury was a net payer of external borrowing.

The domestic roll-over ratio stood at 107.6 percent in the end of September 2018 (Chart 6.2.5). In this period, public financing need was mostly met via domestic borrowing; some part of public deposits was

used to meet financing need as well. The average domestic borrowing real interest rate has increased significantly[1] due to the recent fluctuations in financial markets and the rise in Turkey's risk premium (Chart 6.2.6).

Chart 6.2.5: Total Domestic Debt Rollover Ratio (%)

Source: Ministry of Treasury and Finance.
* As of September.

Chart 6.2.6: Interest Rate at the Treasury Auctions and Maturity Structure*
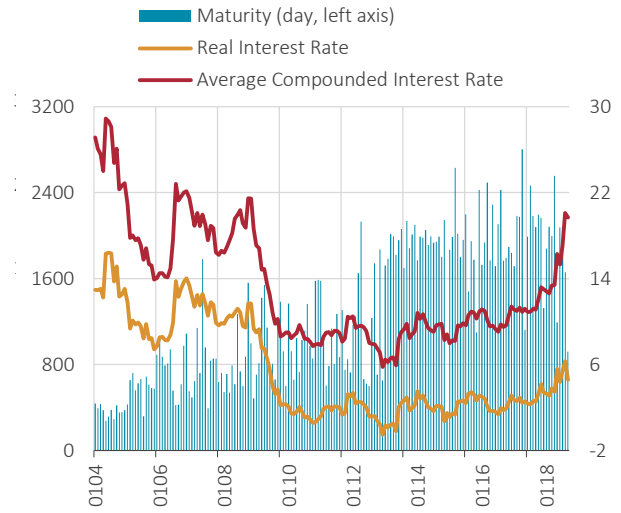
Source: Ministry of Treasury and Finance.
* As of September.

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[1]Real interest rate is calculated by subtracting the 12-month-ahead inflation expectations of the CBRT Survey of Expectations from nominal interest rates at the Treasury's auction.

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).
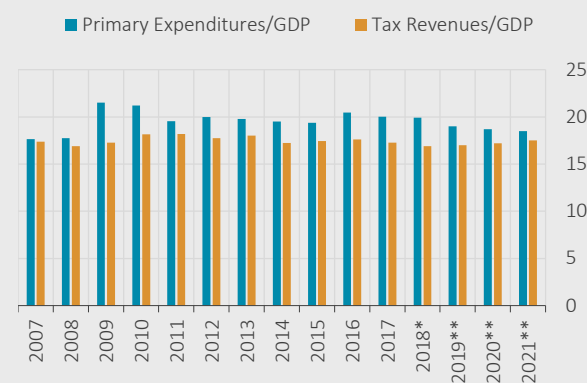[1] Realization estimation.
[2] Program.

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)

■ Primary Expenditures/GDP   ■ Tax Revenues/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)

—— Cyclically-Adjusted Primary Budget Balance / Potential GDP
—— Primary Budget Balance / GDP
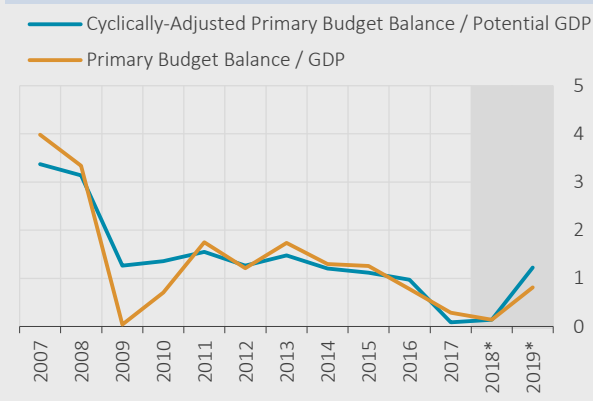
Source: Ministry of Treasury and Finance, CBRT calculations.
* Estimation.

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