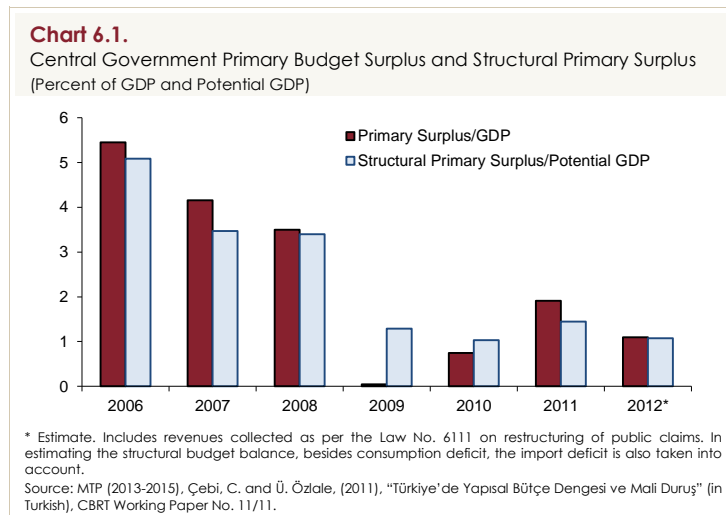


6. Public Finance

In the first three quarters of 2012, budget performance has been sluggish due to the marked slowdown in tax revenues amid the balancing in the economic activity, the adverse base effect driven by the year-on-year decline in the tax revenues collected as per the Law No. 6111 on the restructuring of public claims, and soaring primary expenditures mainly fuelled by surging personnel expenditures. On the other hand, hikes to the SCT rates in motor vehicles and the lump-sum taxes in fuel and alcoholic beverages as well as title fees under the fiscal measures enforced in September in order to raise revenues are expected to bolster budget revenues in the last quarter of the year.

The MTP covering the 2013 - 2015 period was announced to the public in October. Accordingly, in 2012, central government primary surplus to GDP is estimated to decline by 0.8 points from 2011. Furthermore, cyclically adjusted structural primary surplus to potential GDP is expected to fall by 0.3 points in 2012 (Chart 6.1). Thus, the fiscal policy is expected to be expansionary in 2012 with respect to MTP forecasts.



The framework laid down in the MTP regarding the public finance envisages a slight year-on-year deterioration in the budget performance in 2012 given the slowdown in the economic activity. The envisioned deterioration is expected to taper off in the upcoming period (Table 6.1). According to the MTP, primary expenditures are expected to edge up in 2012 and 2013, and decline gradually as of 2014. In addition, the MTP targets to raise tax revenues by legal and administrative regulations and gradually reduce the public sector

borrowing requirement as of 2013. Accordingly, the public sector debt stock to GDP, which has started to decline since 2010, is envisioned to decrease further 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**	2015**
Budget Revenues	22.5	23.1	22.8	22.9	23.6	23.1	22.6
Budget Expenditures	28.0	26.8	24.1	25.3	25.7	25.1	24.4
Budget Balance	-5.5	-3.6	-1.3	-2.3	-2.2	-2.0	-1.8
Budget Revenues (Program-Defined)	21.0	21.8	22.2	22.0	22.8	22.5	22.1
Primary Expenditures (Program-Defined)	22.5	22.2	20.9	21.9	22.3	21.9	21.4
Primary Balance (Program-Defined)	-1.5	-0.5	1.3	0.2	0.5	0.6	0.7
Public Sector General Balance	-5.1	-2.3	-0.1	-1.7	-1.5	-1.1	-0.9
EU-Defined Nominal Debt Stock	46.1	42.4	39.2	36.5	35.0	33.0	31.0

* Estimate.

** Target.

Source: MTP(2013-2015).

Following the deterioration in the public finance in 2012, the MTP targets point to a limited tightening in the fiscal policy and a sustained decline in public debt stock in the forthcoming period. However, it should be emphasized that strengthening the fiscal framework by institutional and structural improvements envisaged in the MTP remains to be of utmost importance with regard to maintaining fiscal discipline on a permanent basis in the medium term.

6.1. Budget Developments

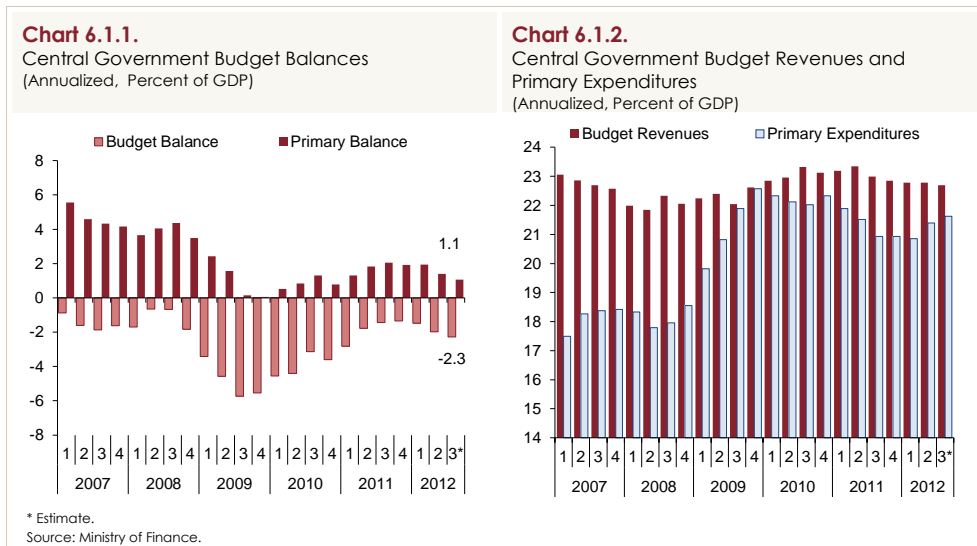
In the first three quarters of 2012, central government budget posted a deficit of TL 14.4 billion, whereas the primary balance registered a surplus of TL 25.2 billion (Table 6.1.1). The slowdown in domestic economic activity and the base effect led by the Law No. 6111 on restructuring of the public claims decelerated the increase in tax revenues, thus causing a year-on-year deterioration in the budget performance. Soaring primary expenditures were also influential on this deterioration.

Table 6.1.1.
Central Government Budget Aggregates
(Billion TL)

	January- September 2011	January- September 2012	Rate of Increase (Percent)	Actual/Target (Percent)
Central Government Budget Expenditures	220.9	258.0	16.8	73.5
Interest Expenditures	34.8	39.5	13.7	78.7
Primary Expenditures	186.1	218.5	17.4	72.7
Central Government Budget Revenues	221.1	243.7	10.2	73.9
I. Tax Revenues	188.4	201.9	7.2	72.7
II. Non-Tax Revenues	25.8	33.2	28.7	75.4
Budget Balance	0.2	-14.4	-	68.0
Primary Balance	35.0	25.2	-28.0	86.4

Source: Ministry of Finance.

Amid falling tax revenues due to the balancing between domestic and external demand and surging primary expenditures, the central government budget deficit to GDP ratio, which reached 1.3 percent in end-2012, gained momentum as of the first quarter of 2012 and climbed to 2.3 percent by the third quarter of 2012 (Chart 6.1.1). The central government primary expenditures to GDP ratio, which surged due to the fiscal measures adopted to limit the adverse effects of the global crisis on Turkey in 2009, still hovers above pre-crisis levels notwithstanding the decline in subsequent years. Moreover, this ratio settled on an upward track in 2012. Having reached recent-highs in the second quarter of 2011, the central government budget revenues to GDP ratio trended downwards amid the slowdown in tax revenues, and remained unchanged in 2012. Despite the slowdown in tax revenues in 2012, budget revenues followed a relatively stable course on the back of hikes in non-tax revenues (Chart 6.1.2).



Central government primary expenditures posted a year-on-year increase by 17.4 percent in the January-September period of 2012. Current transfers and personnel expenditures, one of the major items in primary expenditures, soared by 21.4 and 18.8 percent, respectively; while purchases of goods and services fell by 0.9 percent. The decline in purchases of goods and services was mainly driven by the plunge in health expenditures. This was led by the coverage of green card holders under the general health insurance scheme, the expenditures of which are included in current transfers. Soaring current transfer expenditures were fuelled by the 25.6 percent increase in health, pension and social benefits. Financing of the budget deficit of SSI is accounted as an expenditure item under health, pension and social benefits. The SSI has showed a poor budget performance as of the onset of 2012 due to

reduced revenues collected as per the Law No. 6111 on restructuring of the premium liabilities as well as the transfer of health expenditures by green card holders to SSI. Accordingly, the financing of SSI by transfer from the central government budget increased by 55.2 percent in the first nine months of 2012. Soaring personnel expenditures in the first nine months of 2012 were mainly driven by rises in salaries and severance pay. Actual to target ratio in personnel expenditures reached 80.7 percent in September, pointing that the year-end target will be exceeded and personnel expenditures, which is a non-flexible expenditure item, should closely be monitored in the upcoming period as a risk item with respect to the central government budget (Table 6.1.2).

Table 6.1.2.
Central Government Primary Expenditures
(Billion TL)

	January- September 2011	January- September 2012	Rate of Increase (Percent)	Actual/Target (Percent)
Primary Expenditures	186.1	218.5	17.4	72.7
1. Personnel Expenditures	55.5	65.9	18.8	80.7
2. Government Premiums to SSI	9.4	10.9	15.4	76.3
3. Purchase of Goods and Services	20.5	20.4	-0.9	70.6
a) Defense and Security	6.0	6.8	13.3	64.6
b) Health Expenditures	4.0	0.4	-89.3	46.7
4. Current Transfers	80.0	97.2	21.4	74.6
a) Duty Losses	1.2	2.1	69.1	48.3
b) Health, Pension and Social Benefits	39.9	50.2	25.6	72.6
c) Agricultural Support	5.8	6.8	18.1	95.2
d) Shares Reserved from Revenues	22.8	25.1	10.2	74.2
5. Capital Expenditures	14.5	15.6	7.5	56.0
6. Capital Transfers	2.7	2.6	-3.2	60.8

Source: Ministry of Finance.

In the first nine months of 2012, central government general budget revenues increased by 9.8 percent year-on-year. Tax revenues went up by 7.2 percent in the said period, while non-tax revenues expanded by 28.7 percent amid the high profit transfer by the CBRT (Table 6.1.3). The decline in the year-on-year tax collection under the Law No. 6111 on the restructuring of public claims put a cap on rising tax revenues. On the back of soaring firm profits in line with the high economic growth in 2011, corporate tax revenues boomed in the first five months of 2012. However, this boom was followed by a mild growth path in ensuing months resulting in a 6.3 percent increase in the first nine months of the year due to base effect driven by the restructuring. On account of the ongoing rise in registered employment, income tax revenues increased by 14.7 percent, thus partially compensating for the relatively low rate of increase in total tax revenues. Meanwhile, consumption-based tax revenues declined amid slowdown in the economic activity. In the first nine months of the year, SCT revenues rose by 7.5 percent, while domestic VAT revenues edged up by 2.7 percent. The decelerating rate of increase in SCT revenues was mainly

attributed to the year-on-year decline in SCT collection on oil and natural gas products and motor vehicles. In the meantime, VAT on imports displayed a year-on-year decline amid the slowdown in imports.

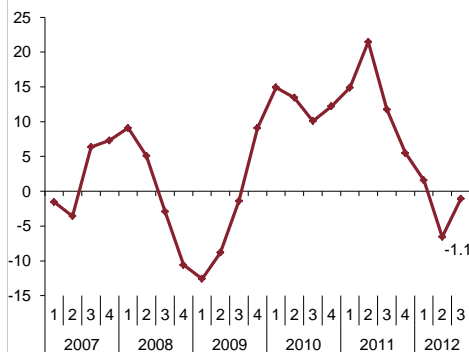
Table 6.1.3.
Central Government General Budget Revenues
(Billion TL)

	January-September 2011	January-September 2012	Rate of Increase (Percent)	Actual/Target (Percent)
General Budget Revenues	214.2	235.1	9.8	73.1
I-Tax Revenues	188.4	201.9	7.2	72.7
Income Tax	35.8	41.0	14.7	76.3
Corporate Tax	19.7	21.0	6.3	77.2
Domestic VAT	23.4	24.0	2.7	71.6
SCT	46.7	50.3	7.5	71.2
VAT on Imports	35.8	35.1	-1.9	65.1
II-Non-Tax Revenues	25.8	33.2	28.7	75.4
Enterprises and Property Revenues	7.5	12.4	65.7	134.1
Interests, Shares and Fines	14.7	16.2	10.2	74.1
Capital Revenues	2.4	1.9	-19.0	16.7

Source: Ministry of Finance.

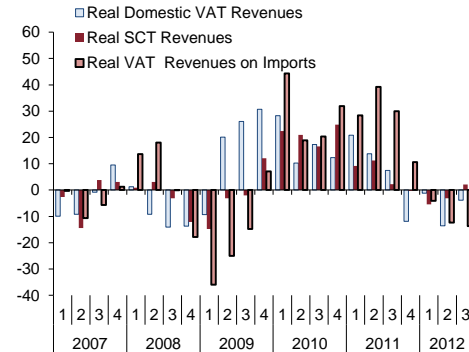
The rate of increase in real tax revenues, which trended downwards as of the third quarter of 2011, turned negative after a 10-quarter period due to the balancing between domestic and external demand as well as the base effect. Then, it dropped by 1.1 percent year-on-year in the third quarter following the 6.6 percent decline in the second quarter of 2012 (Chart 6.1.3). Consumption-based tax revenues are the major tax items that are adversely affected from the balancing between domestic and external demand. Accordingly, in real terms, SCT revenues, which have a significant share in tax revenues, increased by 2.1 percent year-on-year in the third quarter of 2012, while domestic VAT revenues and VAT on imports fell by 3.8 and 13.7 percent, respectively (Chart 6.1.4).

Chart 6.1.3.
Real Tax Revenues
(Annual Percent Change)



Source: Ministry of Finance.

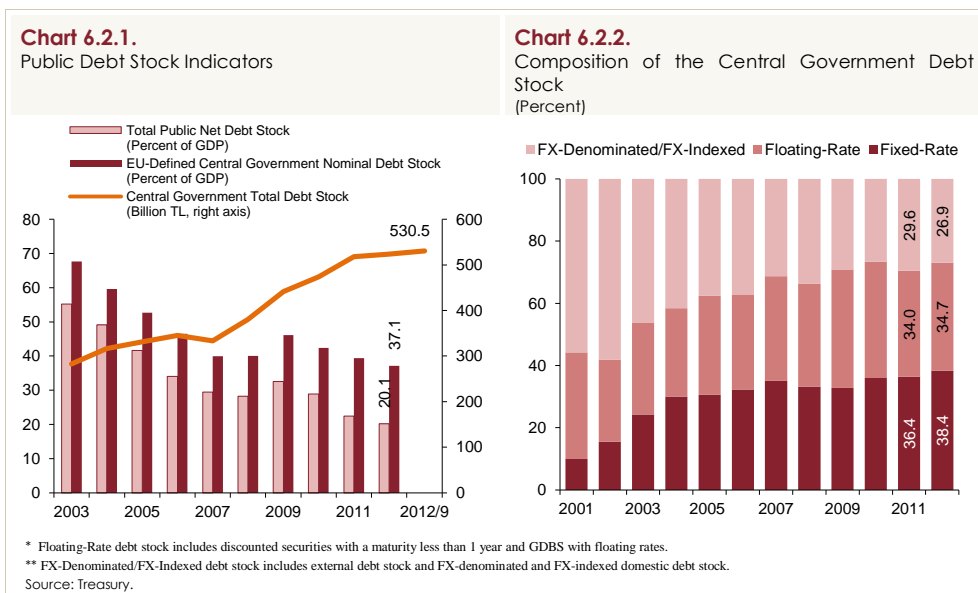
Chart 6.1.4.
Real VAT and SCT Revenues
(Annual Percent Change)



6.2. Public Debt Stock Indicators

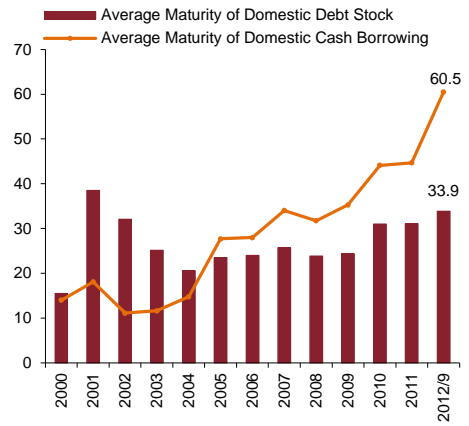
Public debt stock indicators have been on an improving track since September 2012. Public debt ratios declined further; the real cost of borrowing stood at low levels; the average maturity of the debt stock was extended; the share of securities with sensitivity to interest and exchange rate was reduced; and domestic debt rollover ratio was lowered.

In the first half of 2012, both the ratio of total public net debt stock and EU-defined central government nominal debt stock to GDP were realized 2.3 percentage points lower than the year-end and reached 20.1 and 37.1 percent, respectively (Chart 6.2.1). Meanwhile, in September 2012, the central government debt stock remained unchanged from 2011 (Chart 6.2.1).



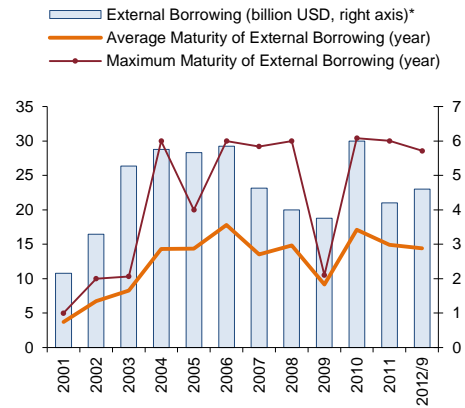
The Treasury has continued with its borrowing strategy to alleviate the sensitivity of the debt stock to liquidity, interest and exchange rate during September 2012 as well. Accordingly, the share of fixed-rate securities in the total debt stock picked up (Chart 6.2.2). The ratio of public deposits to average monthly debt service reached 293.7 percent. Term-to-maturity of the domestic debt stock hit 33.9 months amid the notable year-on-year increase in the average maturity of the domestic cash borrowing (Chart 6.2.3). External borrowing by bond issues amounted to USD 4.6 billion, with the average maturity remaining unchanged at 14.4 years since 2011 (Chart 6.2.4).

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



Source: Treasury.

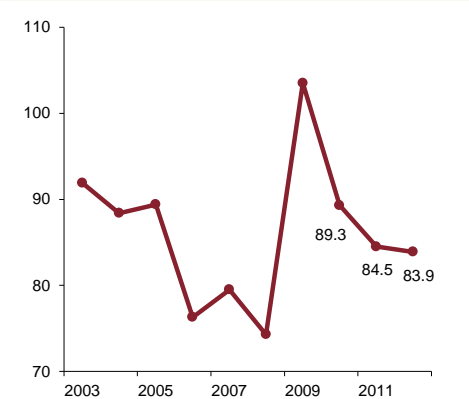
Chart 6.2.4.
Borrowing By Bond Issue



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

Domestic debt rollover ratio realized as 83.9 percent in the first eight months of 2012 (Chart 6.2.5). According to the Treasury's domestic borrowing strategy announced for October-December 2012 period, this ratio is envisioned to decline to 84.1 percent at year-end. The average real interest rate at discount auctions, which slumped between 2009 and 2011, follows a low course (Chart 6.2.6).

Chart 6.2.5.
Total Domestic Debt Rollover Ratio (Percent)



Source: Treasury, CBRT.

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

