

2008 CENTRAL GOVERNMENT BUDGET PRE-EVALUATION NOTE

I- 2008 Fiscal Year Central Government Budget Results: Is fiscal discipline really maintained?

According to the temporary budget implementation results for the fiscal year 2008 as disclosed by the Ministry of Finance, central government budget recorded 17.1 billion YTL deficit. Primary surplus under the official definition stood at 33.6 billion YTL.

Table 1: Central Government 2008 Budget Estimates and Realization

	(million YTL)	Initial Budget	July Expection Rep. Real. Est.	October Budget Estimations	Year-end Realization	July Revision (%)	October Revision (%)	Real.rate based on Initial Budget (%)	Real. rate based on October Rev. (%)
Central Government Budget Expenditures		222.553	232.899	229.535	225.967	4,6	3,1	101,5	98,4
Budget Expenditures Exlcuing Interest		166.553	177.149	175.035	175.306	6.4	5.1	105.3	100.2
Interest Expenditures		56.000	55.750	54.500	50.661	-0.4	-2.7	90.5	93.0
Central Government Budget Revenues		204.556	216.990	215.396	208.898	6,1	5,3	102,1	97,0
Tax revenues		171.206	174.615	174.745	168.087	2,0	2,1	98,2	96,2
Non-tax Revenues		33.350	42.375	40.651	40.811	27,1	21,9	122,4	100,4
Privatization		3.900		9.281	8.889		138,0	227,9	95,8
Budget Balance		-17.997	-15.909	-14.139	-17.069	-11,6	-21,4	94,8	120,7
Primary Budget Balance		38.003	39.841	40.361	33.592	4,8	6,2	88,4	83,2
Program defined Primary Budget Balance		31.289		24.558	17.740		-21,5	56,7	72,2

With the light of these figures, it is claimed that central government budget deficit stood below the 17.9 billion YTL deficit as estimated at the beginning of the year and that this serves as an indicator of fiscal discipline. It is considered useful to highlight some points with a view that there are doubts concerning such observations being realistic.

First of all, these results shall be compared not along to the revenue, expenditure and deficit estimations made at the beginning of the year but also to the realization estimations made for 2008 when 2009 budget is presented to the Parliament in October 2008. There are two reasons behind this: The first is revising the budget estimations in accordance with the basic macroeconomic parameters such as inflation, growth rate and balance of payments as well as with the realizations with respect both to budget expenditures and budget revenues at the end of the first eight months of the year; The second is reflecting the policy decisions affecting during the year, budget revenues and expenditures into the budget estimations. If the evaluations are not made considering both budget estimates, the results to be reached and the comments to be made will not only be incomplete but also misleading.

As temporary results for 2008 suggests, total expenditures in general stands above the budget estimates at the beginning of the year but below the October realization estimations. On the other hand, primary expenditures were recorded high above the initial estimations and in line with October

realization estimations. It should be noted that the main item determinant for the overall expenditure performance is the interest expenditure. Interest expenditures recorded at 56 billion YTL at the beginning of the year and 54.4 billion YTL at the October realization estimations realized at 50.6 billion YTL as of the end of the year.

Table 2: 2008 Central Government Budget Estimations and Realization

CENTRAL GOVERNMENT BUDGET

	2008			2008		
	Budget	Real. Est.		Budget (Oct 2008)	Real. Est.	
		(Oct 2008)	Real.		(Oct 2008)	Real.
General Budget Expenditures	222.553	229.535	225.967	23,5	23,1	22,7
Expenditures Excluding Interest	166.553	175.035	175.306	17,6	17,6	17,6
I. Personnel Expenditures	48.672	50.128	48.825	5,1	5,0	4,9
II. Government Premiums to Social Security Agencies	6.405	6.677	6.402	0,7	0,7	0,6
III. Goods and services Purchase	22.905	24.750	23.941	2,4	2,5	2,4
IV. Interest Expenditures	56.000	54.500	50.661	5,9	5,5	5,1
V. Current Transfers	69.207	68.694	70.116	7,3	6,9	7,1
VI. Capital Expenditures	11.775	17.675	18.441	1,2	1,8	1,9
VII. Capital Transfers	2.084	2.803	3.173	0,2	0,3	0,3
VIII. Liability	3.934	4.308	4.411	0,4	0,4	0,4
IX. Reserve Appropriations	1.571			0,2		
Central Government Budget Revenues	204.556	215.396	208.898	21,6	21,7	21,0
I. General Budget Revenues	199.411	210.336	202.790	21,1	21,2	20,4
A. Tax Revenues	171.206	174.745	168.087	18,1	17,6	16,9
Direct Taxes	56.629	61.072	59.020	6,0	6,1	5,9
Indirect Taxes	114.577	113.673	109.067	12,1	11,4	11,0
B. Non-tax Revenues	28.205	35.590	34.703	3,0	3,6	3,5
Privatization*	3.900	9.281	8.889	0,4	0,9	0,9
Other	24.305	26.309	25.814	2,6	2,6	2,6
II. Revenues from Special Budget Institutions	3.417	3.340	4.369	0,4	0,3	0,4
III. Revenues from Regulatory and Supervisory Agencies	1.728	1.721	1.740	0,2	0,2	0,2
Budget Balance	-17.997	-14.138	-17.069	-1,9	-1,4	-1,7
Budget Balance. (excluding Privatization & Unemp Fund Rev)	-21.897	-24.719	-25.458	-2,3	-2,5	2,7
Primary Balance	38.003	40.362	33.592	4,0	4,1	3,4
Program Defined Balance	31.289	24.558	17.740	3,3	2,5	1,8

The sub items of non interest expenditures showing an upwards trend are as well striking. The mentioned sub-items can be listed as the following;

- Purchases of goods and services exceed the level in the initial budget by slightly more than 1 billion YTL, but stands below the revised estimation. The main factor determining the change in the purchases of goods and services as compared to the initial budget is the realization of purchases of other goods and services 1.3 billion YTL above the allowance. This is detected to be predominantly the outcome of the increase in the input costs, cost of electricity and natural gas and exceeding the allowances for service inputs, travel pays and duty payments.
- Level of current transfers realized above both the initial estimations and the realization estimations due to the duty losses, agricultural subsidies and the share transferred to local administrations. Financial outcomes of the restructuring of debts of the private sector due to social security premiums avoided a level of current transfers further above the allowance amount.

- Capital expenditures item is among the ones that exceed both the initial allowance amount and the realization estimations most. The rise above the allowance level with respect to the initial target was recorded as 6.6 billion YTL. The expansion of the expenditures under this item was determined by the funds transferred from the privatization fund as well as the additional funds transferred from the asset sale and unemployment fund totaling 10.2 billion YTL.
- Capital transfers item, with the effect to the funds transferred to local administrations, stood quite high above both the initial allowance amount and revised allowance amount and the mentioned item ranked among the ones that deviate from the initial allowance level most.
- Personnel expenditures realized nearly at the level of the initial allowance and slightly below the revised target. At the same time, the fact that all payments made to public personnel are not included in the budget leads to an incomplete fiscal picture since a proportion of the payments are made from out-of-budget funds through working capital.
- The volume of payment arrears due to the health sector and constructors and but kept out of the budget accounts in 2008 is unknown.
- Housing Support payments were made from the budget.

Therefore, it seems impossible to claim that the expenditure realizations reflect the whole picture.

The magnitude of the deviations with respect to the revenue items is more remarkable.

- While tax revenues were estimated to be 171.2 billion YTL and 174.7 billion YTL at the beginning of the year and at the realization estimations made three months before the end of the year, respectively, year-end realization was recorded as 168.1 billion dollars. Indirect taxes decreased as compared to the initial estimations (4.8 %) while direct taxes rose (4.2 %). As compared to the revised estimations, both direct and indirect tax revenues demonstrated a fall (4.1 % and 3.4 %, respectively).
- The most striking development is that, the estimation for collections after asset sales, set at 3.9 billion YTL upon recording the cash surplus of the Privatization Fund as a revenue item of the central government budget as per the regulations introduced in the midyear, was increased to 9.3 billion YTL in the realization estimates for the same revenue and was realized at 8.9 YTL as per the year end. Because, with the mentioned regulation, a virtual period-specific correction (a patch) in central government budget through the contribution of the Unemployment Fund amounting to 1.3 billion YTL was introduced.

As a cumulative result, while the budget was expected to close the year with a 17.9 billion YTL deficit in the initial estimates and with 14.1 YTL in the realization estimates, 17.1 billion YTL deficit was encountered. In brief, budget deficit realization did not match up with the estimates revised a few months ago.

The deterioration of the budget deficit in the last quarter of the year proves more striking as compared to that of the same period last year. This situation was also highlighted in the earlier Fiscal Monitoring Reports by TEPAV. Furthermore, the fact that almost half of the amount of budget deficit

was realized in the last month of the year indicates that the “December Fever” in the public finance remains present.

Since the budget deficit, which was estimated to be 14.1 billion YTL a few months before the end of the year, realized at a much more higher level at the end of the year, it is not possible to consider the claim that initial budget target was achieved as a realistic approach in terms of the credibility of the budget. As touched upon by in the previous reports, transfers from Privatization Fund or Unemployment Fund, which shall not be recorded as revenue items, are included in the budget, while Housing Support (KEY) payments that shall be included in the budget are left and paid out of the budget.

By this way, it is sought to make the central government budget seem “more beautiful” at the cost of deteriorating the fiscal condition of the Unemployment Fund and Privatization Fund. Despite these, central government budget deficit a lower value for which was estimated to realize stands at a much higher level with a deviation of approximately 20.7 % just a few months after the date that the estimations were made. Making targets changeable and claiming under these circumstances that the targets are achieved, fiscal discipline is maintained and a good budget management performance was ensured signalize a serious problem of inconsistency.

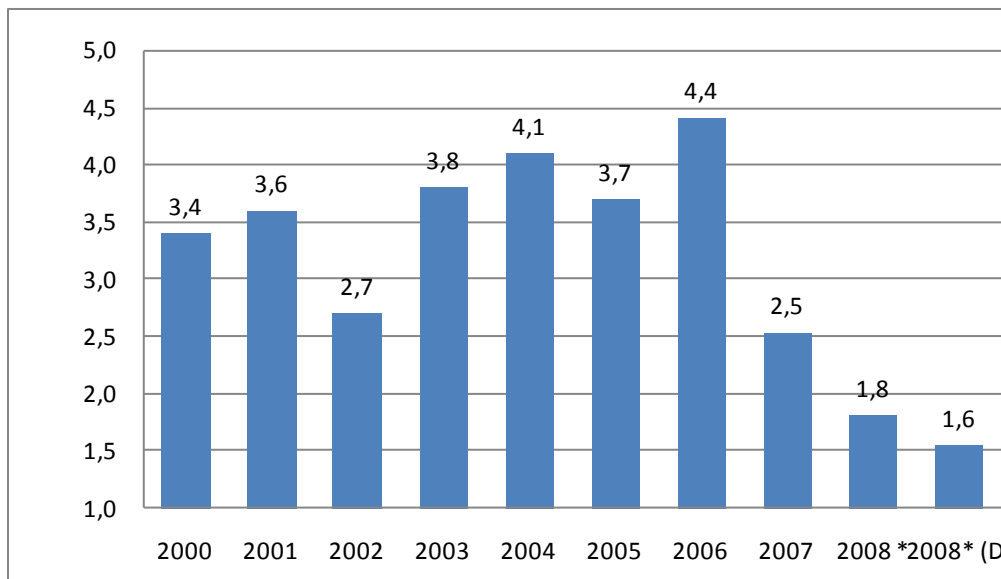
II- How Shall the True Fiscal Performance Be Calculated?

It is believed that the healthiest approach will be to evaluate the level of the primary balance in terms of both the initial estimations and realization estimations after calculate the level of primary balance (program defined / adjusted) excluding the nontransparent interventions, ad-hoc measures and similar transactions carried out throughout the year from the budget.

It is striking that even the officially-defined primary surplus realized below both the initial estimations and the realization estimates, i.e. none of the targets were reached, in spite of such interventions.

Furthermore, the program defined / adjusted primary surplus reflecting the actual fiscal performance realized 14 billion YTL below the initial target and 7 billion below the realization estimation indicating the worst fiscal performance since 2000, when the implementation of stability programs was initiated. As can be observed in the graph below, program defined primary surplus exceeding 4 % in terms of the ratio to GDP, fell sharply down to 1.8 % as the ratio to the GDP in 2008 indicating the worst performance in the last nine years. As Housing Support payments are included, the ratio further falls down to 1.6 %.

Graph 1. Central Government Budget Movement of Program Defined Primary Surplus (% of GDP)



* 2008 GDP estimation as provided in the SPO 2009 program

D: Program defined adjusted balance after the inclusion of Housing Support payments

Source: 2000-2004 (2000-2007, IMF Staff Reports; 2005-2008, Treasury and own estimates of the report group)

III- Consequently;

Statements deeming the fiscal performance in 2008 in terms of budgetary discipline was high are unrealistic and optimistic.

It is observed that while the performance of the budget expenditures for 2008 fiscal year is based on measures like nontransparent recording systems, deferred expenditures the which are of dubious quality, balance is tried to be maintained via transferring the liquid assets of other public agencies to the account of the revenue items of the central government budget.

Despite all, the erosion observed in the Turkish Tax System that is based on indirect taxes and directly affected by growth (through the change in the level of aggregate demand) seems to have more and more impact on the inability to achieve fiscal performance targets.

Adjusted primary budget lags behind the targets.

Especially the last quarter of the year demonstrates the most prominent deterioration in the budget.

With this respect, the overall circumstances cannot be considered as a success in terms of fiscal discipline.

The case observed for 2008 fiscal year seems to have already risked the credibility of the budgetary estimates for 2009.

Fiscal Monitoring Report including a comprehensive evaluation of TEPAV for t 2008 fiscal year budget implementation results will be released soon.