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Sarp KALKAN[1]
Analyst, Economic Studies

IT IS THE PUBLIC SECTOR THAT SHOULD BOOST DOMESTIC SAVINGS

Turkey's current account deficit problem and the underlying low savings rate phenomenon have been the top items of the economic agenda lately. The government also has been endeavoring on this challenge as revealed by the measure package announced last week by Ali Babacan, Vice Prime Minister Responsible for the Economy.

The six-item package involves important incentives for boosting private savings particularly via the individual pension plan. This implies a critical step towards deepening the system which is in effect since 2003 and currently has a portfolio of ₺16 billion with 2.7 million individual investors.

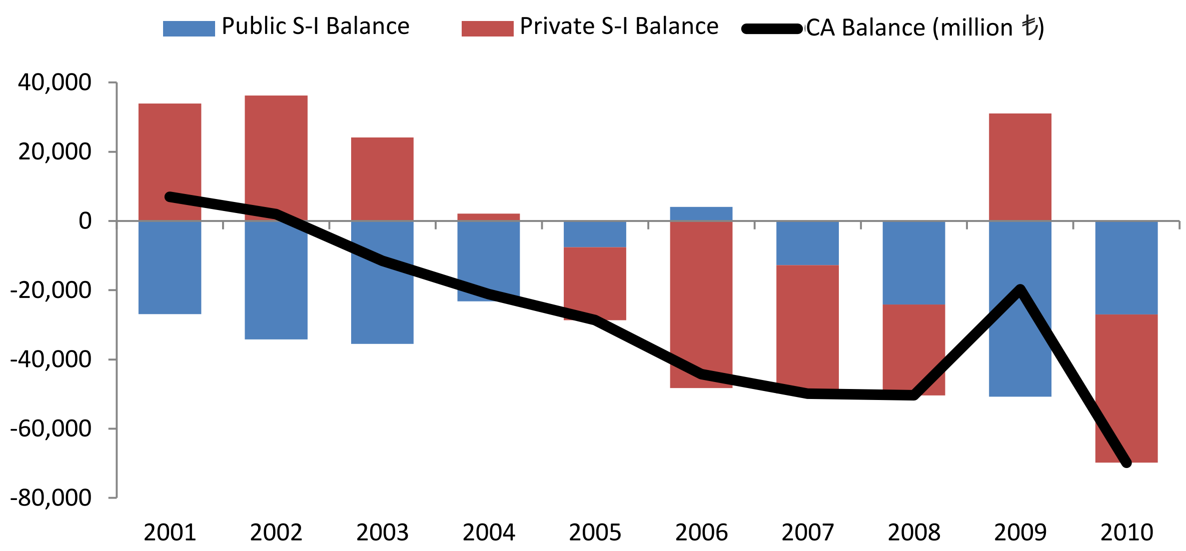
[1] http://www.tepav.org.tr/en/ekibimiz/s/1034/Sarp+Kalkan

The outlook public savings

As the new package notifies, the public sector has taken the initiative in enhancing private sector savings. But what is the outlook of public savings that is under the direct influence of the public sector? Current account deficit equals the savings-investment deficit of the public sector and the saving-investment deficit of the private sector (S-I). In other words, current account deficit means that public and private savings do not meet public and private investments.

In all years over the last decade but 2006, public sector made a significant contribution to current account deficit (Figure 1)[2]. The easiest way to investigate the changes in public savings deficit is to take a closer look at budget dynamics.

Figure 1. Components of Current Account Deficit: Public and Private Sector Savings-Investment Balance



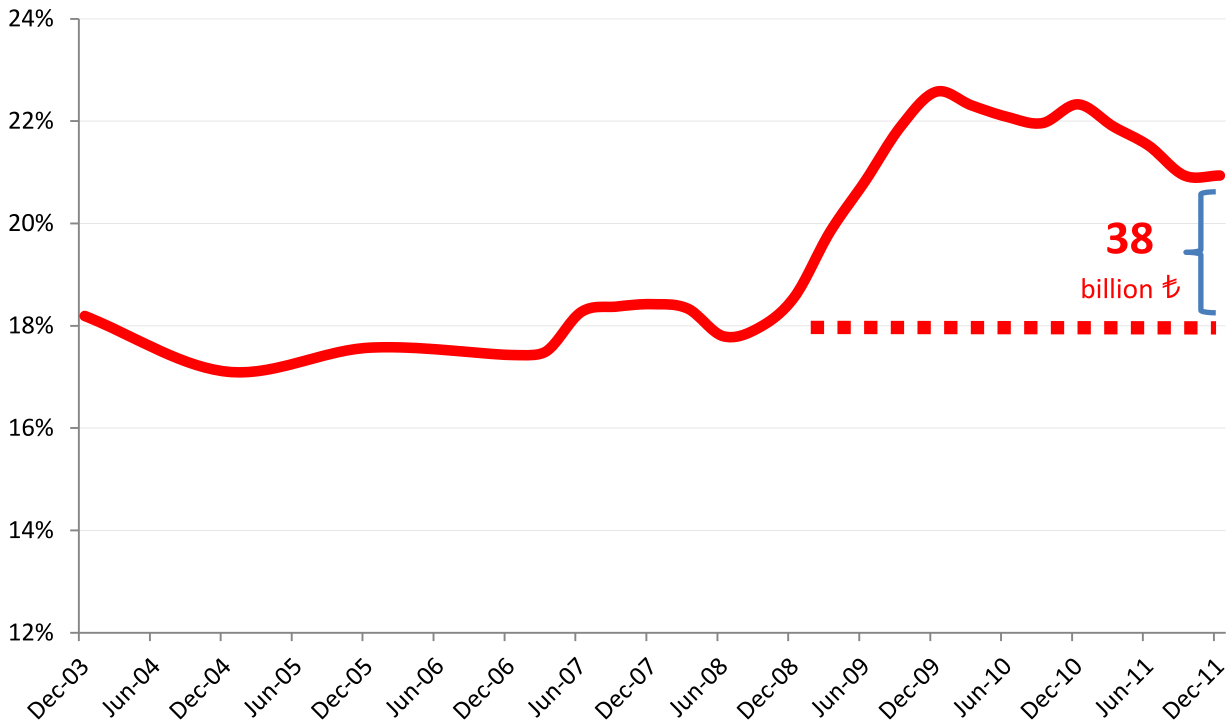
Source: CBRT, Ministry of Development, TEPAV's calculations

We all know that the budget balance is in a good state and that the primary surplus of ₺25 billion recorded as of the end of 2011 was a great relief for the economy. But are we aware of the changes in sub-components? Indeed, in the recent period, a visible behavioral change was observed particularly concerning budget expenditures. The figure below gives a brief outlook of this (Figure 2).

[2] According to the General Equilibrium tables issued by the Ministry of Development, public savings-investment deficit accounted for the entire current account deficit in 2009 and the 39 percent of it in 2010. The Ministry estimates that in 2011, public savings-investment deficit will account for 17 percent of the current account deficit.

Interest expenditures were eased substantially thanks to recent policy efforts. Therefore, interest expenditures in proportion to GDP decreased from 17 percent in 2011 to 3 percent recently, particularly driven by the performance in 2010 and 2011.

Figure 2. Primary Budget Expenditures in Proportion to GDP (12 months cumulative)



Source: Public Accounts, TURKSTAT, TEPAV's calculations

At the same time, primary expenditures were successfully kept at 18 percent in proportion to GDP during the period of tight fiscal policy between 2003 and 2008. Following the global crisis, the ratio reached 23 percent due to both the contraction of GDP and the measures initiated to stimulate markets. The expansionary fiscal policy in effect in 2009 and 2010 was extremely helpful in picking up the pieces of the economy after the crisis.

In 2011, when Turkey attained a record-high growth rate beyond that estimated by the Medium Term Program, primary expenditures was not able be lowered to pre-crisis level. Hikes in temporary expenditures became permanent and primary budget expenditures in proportion to GDP reached 20.9 percent. Hikes were severe especially in personnel expenditures, government premiums to social security agency and current transfers while the rise in investment expenditures (productive capital) was weak.

Figure 3. Change in Primary Budget Expenditures and Sub-Components

(proportion to GDP)	2006-2008 Average	2011	Change
Personnel Payments and SSI Premiums	4.8%	5.6%	0.8%
Current Transfers	7.1%	8.5%	1.4%
Expenditures on Immovable Property for Production	1.1%	1.8%	0.7%
Primary Budget Expenditures	18.0%	20.9%	2.9%

Source: Public Accounts, TURKSTAT, TEPAV's calculations

Public savings could have been increased by ₺38 billion

If primary budget expenditures in 2011 could have been lowered to the 2003-2008 average at 18 percent, additional fiscal space of ₺38 billion would have been created. In other words, public savings could have been ₺38 billion higher. The public administration that was able to keep primary expenditures at 18 percent in proportion to GDP still has the ability to lower expenditures to the mentioned level. But it appears that policy makers have considered a significant part of the extra fiscal space as a source of finance for raising current expenditures. The preference to raise personnel expenditures and long-term share distributions over one-time expenditures made the rise in expenditures permanent.

With this perspective, we can conclude that the scope of the policy tools that can be used to improve public savings is way beyond that defined in the latest policy package. By increasing public savings in particular, overall domestic savings can be enhanced[3], enabling a significant progress in the solution of current account deficit problem. For instance, if public savings in 2011 are increased by ₺38 billion, current account deficit can be lowered by $14 billion, corresponding to a deficit of 8.2 instead of 10 percent in proportion to GDP[4].

[3] According to the Ricardian Equivalence Theorem, public savings and private savings are perfect substitutes for each other. Any increase in one reduces the other and thus overall domestic savings remain constant. However, the World Bank report "Sustaining High Growth: The Role of Domestic Savings" published in 2012 states that there is no full Ricardian equivalence in Turkey and thus domestic savings can be improved by increasing public savings.

[4] Calculated on the basis of the Ricardian offset coefficient of 0.38 as identified in Pirgan Matur E., A. Sabuncu, and S. Bahçeci. 2012. "Determinants of Private Savings and Interaction Between Public and Private Savings in Turkey."

Having missed this opportunity in 2011, it is even more critical to take an action in 2012. Enhancing public savings, that is, tightening the public budget is of vital importance for the fight with current account deficit. Nevertheless, the main principle when raising public savings must be reducing current expenditures or transfers instead of increasing taxes or cutting productive investments.

As the current picture reveals, the fight with current account deficit requires the tightening of fiscal policy as well as of monetary policy. The present level of primary expenditures signals that there is enough room for such tightening.