

Comparing the Fiscal Rule and the Medium Term Plan 2011-2013

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Abstract

On October 10th, the government announced its Medium Term Programme (MTP) for the 2011-2013 period. Earlier this year, deputy prime minister Ali Babacan had proposed a fiscal rule to reduce Turkey's budget deficit and its debt to GDP ratio in the long run. Later, however, the Fiscal Rule was denounced by the prime minister Tayyip Erdoğan who put his objection in words on TV saying "There is no need to create an IMF inside".

This research brief compares the official budget deficit target announced in the MTP to that of the proposed (and denounced) Fiscal Rule. Had the Fiscal Rule actually legalized what would Turkey's budget deficit target be and how does it compare to that of the MTP? The short answer is – it would have been the same.

Target budget deficit

Here we calculate the target budget deficits according to the fiscal rule for the centralized government budget and general government balance with and without the privatization revenues.

We consider four different budget definitions:

1. Central Government Budget
2. General Government Balance
3. General Government Balance excluding privatization revenues
4. Central Government Budget excluding privatization revenues

Privatization revenues are usually excluded in fiscal rule formulations. The reason for this is twofold. One is that the main goal for the fiscal rule is to have fiscal discipline.

As part of that ideally the privatization revenues should be used to pay back debt and reduce the budget deficit instead of used as a resource for more spending. The second reason for exclusion is that whether the privatization revenues will actually be materialised is highly uncertain.

Table 1 shows the budget deficit targets for each budget definition considered, during the period 2011-2013.

When privatization revenues are excluded the Fiscal Rule and the Medium Term Programme targets are almost identical for the General Government Balance. Only in 2012 the MTP is not as tight as the fiscal rule but the difference is small – only 0.2 percentage point.

In 2011 the MTP foresees a reduction of budget deficit from 4.0 percent to 3.2 and further to 2.7 percent in 2012 and 1.8 percent in 2013. Under the fiscal rule we would have 3.2, 2.5 and 1.8 percent respectively.

When the privatization revenues are included however, in both centralized and general government definitions of the budget the announced MTP is actually tighter than that of the proposed Fiscal Rule formulation.

As a result, even if Turkey had agreed to apply the Fiscal Rule, the medium term public spending would not have been any different. However, not only that the cancellation of the Fiscal Rule proposal and the sharp denouncement of it by the prime minister created an uncertain outlook on fiscal discipline ahead of the elections for a while, but also has dimmed the hopes for a long term commitment to fiscally responsible policy by Turkey, at least until after the elections.

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Table 1: Budget Targets 2010-2013 (as percentage of GDP, all deficits)

	Medium Term P.			Fiscal Rule		
	2011	2012	2013	2011	2012	2013
Including Privatization Revenues						
Central Government Budget	2.8	2.4	1.6	3.2	2.5	1.8
General Government	2.1	1.8	1.1	3.0	2.3	1.7
Excluding Privatization Revenues						
Central Government Budget	3.9	3.3	2.3	3.4	2.6	1.9
General Government	3.2	2.7	1.8	3.2	2.5	1.8

Source: State Planning Organisation, Betam.

Appendix: The proposed Fiscal Rule formulation and calculations

The proposal for the Fiscal Rule included a formulation which relates the change in the budget deficit in a given year to the difference between the previous year's budget deficit and the target long-run budget deficit, and the difference between the same year growth rate and the target long-run growth rate.

The exact formulation is given below:

$$a_t - a_{t-1} = -0.33*(a_{t-1} - 1) - 0.33*(b_t - 5)$$

a_t : budget deficit in year t as percentage of GDP

a_{t-1} : budget deficit in year t-1(previous year) as percentage of GDP

b_t : real GDP growth rate in year t

In the MTP, expected GDP growth rates and budget deficits are provided for years 2010-2013. We calculate the Fiscal Rule target budget deficits using these predictions for the relevant years.

For example, the 2010 budget deficit target and 2011 growth rate forecast is used in calculating the 2011 budget deficit target according to the formulation above.

For year 2012, 2011 growth rate forecast and the calculated budget target for year 2011 is used. The calculations for 2013 follows.
